2002 ANNUAL REPORT

Canadian Pacific Railway

Ingenuity.

CHAIRMAN'S MESSAGE 2002 was a challenging and successful year for Canadian Pacific Railway. It was CPR's first full year as an independent public company since its spin-off from Canadian Pacific Limited. I am pleased to report that CPR has emerged from this planned and orderly transition as a reinvigorated organization with renewed purpose and a strong vision.

GOOD GOVERNANCE IS GOOD BUSINESS.

Our company proved in 2002 that it can perform very well on its own, even when confronting adverse circumstances beyond its control. In 2002, these included a mixed economic recovery and a drought on the Canadian prairies that significantly reduced grain revenue.

The management and employees of CPR responded vigorously to these challenges, capitalizing on changing market dynamics and well-timed investments. The results of their efforts were a record level of operating income for CPR and the best operating ratio in the company's long history. CPR is closing in steadily on management's committed target of a 73 % operating ratio.

It is my job as Chairman to ensure shareholders have an effective Board of Directors that, chief among its responsibilities, puts in place the processes and structures needed for the highest standard of governance. Simply put, good governance is good business.

In particular, I strongly believe that a Board of Directors should be comprised of seasoned individuals with diverse industry experience and sound business judgment. I am satisfied that CPR's Board meets this standard and that the Board and its committees clearly understand their roles as articulated in the committee charters. CPR's Board and its committees also have independent access to legal, financial and other specialized resources, as well as to internal and external audit staff.

The talents of our Board members combined with role clarity and independent access to resources and audit personnel provide for the effective oversight of CPR's operations and business performance. This creates a solid foundation for CPR's governance framework.

Every year brings new challenges and undoubtedly 2003 will be no different. However, I am confident that with the Board, the management, and the employee team we have in place, CPR will meet all the challenges the world throws at it and we will continue to build our company for future growth.

J.E. Newall
Chairman of the Board

MANAGEMENT'S DISCUSSION AND ANALYSIS This Management's Discussion and Analysis supplements the consolidated financial statements and related notes contained in the 2002 Annual Report to Shareholders. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars.

OPERATING RESULTS

Canadian Pacific Railway Limited's ("CPR" or "the Company") operating income was $857 million for 2002, reflecting an increase of $40 million over $817 million in 2001 and an increase of $12 million over $845 million in 2000. Excluding non-recurring items, full-year operating income of $857 million for 2002 increased $16 million over $841 million in 2001 and $12 million over $845 million in 2000. CPR's operating ratio (total operating expenses divided by total revenues), excluding non-recurring items, for 2002 was 76.6 %, an improvement of 0.7 points from 2001 and an improvement of 0.3 points from 2000. CPR posted record results for operating income and operating ratio in 2002.

Total revenues in 2002 were $3,666 million, a decrease of $33 million from $3,699 in 2001 and an $11-million increase over $3,655 million in 2000. Freight revenues in 2002 were $3,472 million, a decrease of $25 million from 2001 and a $12-million increase over 2000.

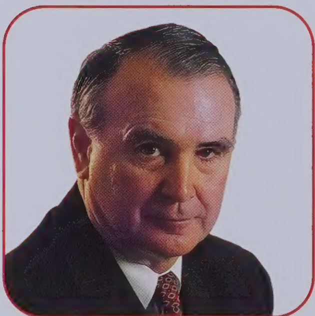
Operating expenses were $2,809 million in 2002, $2,882 million in 2001 and $2,810 million in 2000. Operating expenses in 2002, excluding non-recurring items, were $2,809 million, down $49 million from $2,858 million in 2001 and down $1 million from $2,810 million in 2000.

Net income was $496 million in 2002, $373 million in 2001 and $503 million in 2000. Diluted earnings per share were $3.11 in 2002, $2.34 in 2001 and $3.17 in 2000. Excluding non-recurring items and foreign exchange gains and losses on long-term debt, CPR's income in 2002 was $407 million compared with $380 million in 2001 and $410 million in 2000. Diluted earnings per share, excluding non-recurring items and foreign exchange gains and losses on long-term debt, were $2.56 in 2002, compared with $2.39 in 2001 and $2.58 in 2000. Net income increased in 2002 due to a decline in operating expenses as CPR continued to focus on containing costs, as well as strong growth in several business sectors that offset a decrease in grain revenues stemming from a prolonged drought in Canada's grain growing region. Interest expense increased $33 million over 2001 and $75 million over 2000. The increase reflected the full-year impact of CPR's new capital structure, with increased debt following the spin-off of the Company from Canadian Pacific Limited ("CPL") in October 2001. Other charges, excluding foreign exchange gains and losses on long-term debt, decreased $5 million from 2001 and remained relatively flat compared with 2000.

CPR's results, excluding foreign exchange gains and losses on long-term debt and non-recurring items as defined in this Management's Discussion and Analysis ("MD&A"), are presented to provide the reader with information that is readily comparable to prior years' results. By excluding foreign exchange gains and losses on long-term debt, the impact of volatile short-term exchange rate fluctuations, which can only be realized when long-term debt

PRESIDENT'S MESSAGE Canadian Pacific Railway had its most profitable year ever in 2002 on the basis of operating income. While I am pleased with our results, it is imperative that we continue to improve our performance so that we have an even greater degree of freedom to build our company and grow shareholder value.

2002 WAS CPR'S MOST PROFITABLE YEAR EVER.



Looking forward, I have set down three aggressive financial performance targets for CPR in the medium term: a 73 % operating ratio; a 10 % return on capital employed after tax; and $200 million cash flow before dividends.

Our eyes are set firmly on those targets and in 2002 CPR made steady progress towards them despite a challenging market environment.

Operating income in 2002, excluding non-recurring items (1), was a record at $857 million, up 2 % from $841 million in 2001. CPR's operating ratio was the best ever at 76.6 %, a 70-basis-point improvement over 2001, excluding non-recurring items (1). Free cash flow after dividends was a record at $132 million.

Return on capital employed after tax was 9.1 %.

2002 was also a record year for revenue in our intermodal and automotive lines of business, and employee productivity reached an all-time high. Moreover, it was our safest year ever for train operations and our employees achieved an on-the-job safety record.

These achievements stem from the fundamental strength, responsiveness, and flexibility of our company today.

We have invested in new assets to support scheduled railway operations, as well as CPR's company-wide safety, service and productivity initiatives. These investments are bringing strong returns. Our employees are applying their ingenuity and entrepreneurial spirit for the benefit of all CPR stakeholders.

Our flexible Integrated Operating Plan accommodates changing traffic patterns and our diverse commodity mix is allowing CPR to perform well even under adverse market conditions.

We experienced adverse conditions in 2002 as drought reduced the grain crop to one of the smallest ever to come off the Canadian prairies and sales by our coal customers declined. Grain revenue was off 16 % and coal revenue fell 7 %. In response, our employees moved quickly to stay ahead of shifting traffic patterns in the intermodal and automotive businesses, and we capitalized on well-timed investments in track capacity and facilities to support our truck-competitive services. As a result, intermodal revenue increased 10 % and automotive revenue rose 9 %, and our industrial products business showed renewed strength in the last quarter of 2002. This put us on a solid footing going into 2003.

On balance, revenues were $3,666 million, down $33 million or 1 % from 2001. When the effect of drought on grain revenue is excluded, CPR generated revenue growth of about 3 %.

We have earned a reputation for very effective expense management and our results in 2002 demonstrated continued success in this critical area. Operating expenses were reduced by $49 million or 2 %

to $2,809 million, excluding non-recurring items[1].

Our company has never been more efficient. Employee productivity, as measured by gross ton-miles of freight handled, rose 4 % in 2002. Freight car utilization is at its highest ever and our fuel consumption rate has never been lower.

Safety remains our Number One priority and CPR continues to lead the industry in safe train operations. Good environmental stewardship runs parallel with our safety effort. In 2002, an independent team verified that CPR's environmental, safety, health and community outreach efforts meet the rigorous standards of Responsible Care®. As a Responsible Care® partner, CPR is committed to continuously improving railway and public safety.

However, it saddens me to report that we suffered one fatal work accident in 2002, as well as a serious train derailment that adversely affected the community of Minot, North Dakota. These tragic events reinforce our conviction that when it comes to safety, our job can never be finished.

We demonstrated repeatedly in 2002 the strength, depth and value of our world-class Integrated Operating Plan. The Integrated Operating Plan is our foundation for running a scheduled railway, and it gave us the agility we needed to capitalize on dramatically changing circumstances in many of our markets. These included a sudden rise in feed grain shipments to drought-stricken central Alberta from the U.S. Midwest, a strike at the Port of Vancouver that saw export grain diverted north to Prince Rupert, record container imports through the Port of Vancouver for Chicago, and a surge in intermodal and automotive volumes over our lines north of the Great Lakes where track capacity was expanded earlier in the year.

We were able to quickly put resources where they were needed and to use them efficiently. As a result, service levels improved through the year even as volumes and traffic type shifted in different rail corridors. Costs per train-mile declined and profitability increased.

CPR has demonstrated it can continuously adapt to customers' changing needs, and do it profitably. Our Integrated Operating Plan, whose stamp is on this success, is a finalist for the international Franz Edelman Award for achievement in management sciences.

We have confidence in our new initiatives to grow the top line. CPR's Expressway product for truck trailers, and our Connetix reload service, which gives shippers of resource products access to CPR's mainline from distant production facilities, went from strength to strength in 2002. Our co-location initiative, under which major retailers have built regional distribution facilities next to our intermodal terminals, helped produce intermodal's record year. We expect further growth from these initiatives in 2003.

The rail industry is at the centre of many of today's critical issues. Rail provides solutions for improving North America's productivity, border security and efficient flow of people and trade. Rail helps lower greenhouse gas emissions, improve the safety of our roads and reduce traffic congestion in our crowded cities. We are putting significant effort into getting that message across to policy makers because everyone benefits from a rail industry functioning at its true potential. This motivates and drives us, and I firmly believe our company's best years lie ahead.

I want to thank our Board and our employees, customers and shareholders for their unflagging support. Together, we are playing to win.

R J Ritchie

Robert J. Ritchie
President and
Chief Executive Officer

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[1] Further information, including non-recurring items and foreign exchange gains and losses on long-term debt, is available on page 2.

matures or is settled, is largely eliminated. By also excluding non-recurring items, the results better reflect ongoing operations at CPR. It should be noted that operating results, excluding non-recurring items and foreign exchange gains and losses on long-term debt, have no standardized meanings and are not defined by Canadian generally accepted accounting principles ("GAAP") and, therefore, may not be readily comparable to similar measures of other companies.

A reconciliation of income, excluding non-recurring items and foreign exchange gains and losses on long-term debt, to net income is presented below.

SUMMARIZED CONSOLIDATED STATEMENT OF EARNINGS

Reconciliation of Non-GAAP Earnings to GAAP Earnings

year ended December 31 (in millions)	**2002**	2001	2000
Revenues	**$ 3,665.6**	$ 3,698.6	$ 3,655.1
Operating expenses, excluding spin-off related and incentive compensation charges [1]	**2,809.1**	2,857.6	2,809.9
Operating income, excluding spin-off related and incentive compensation charges in 2001 of $24.5 million [1]	**856.5**	841.0	845.2
Other charges, excluding foreign exchange gains and losses on long-term debt ("FX on LTD") and bridge financing fees related to spin-off [1]	**21.8**	26.4	21.0
Interest expense	**242.2**	209.6	167.0
Income tax expense, excluding FX on LTD, income tax recovery and income tax on non-recuring items [1] [2]	**185.2**	224.7	247.1
Income, excluding non-recurring items and FX on LTD [1] [2]	**407.3**	380.3	410.1
FX on LTD [2] (net of tax)	**16.7**	(48.2)	(39.2)
Non-recurring items:			
Spin-off related and incentive compensation charges	**–**	(24.5)	–
Bridge financing fees related to spin-off	**–**	(17.2)	–
Income tax recovery	**72.0**	64.0	131.7
Income tax on non-recurring items	**–**	18.1	–
GAAP net income [2]	**$ 496.0**	$ 372.5	$ 502.6
Basic earnings per share, excluding non-recurring items and FX on LTD [1] [2]	**$ 2.57**	$ 2.40	$ 2.59
Diluted earnings per share, excluding non-recurring items and FX on LTD [1] [2]	**$ 2.56**	$ 2.39	$ 2.58
Basic earnings per share [2]	**$ 3.13**	$ 2.35	$ 3.18
Diluted earnings per share [2]	**$ 3.11**	$ 2.34	$ 3.17

[1] Excludes non-recurring items, as described under Non-Recurring Items in this MD&A. These earnings measures have no standardized meanings and are not defined by Canadian generally accepted accounting principles ("GAAP") and, therefore, may not be readily comparable to similar measures of other companies.

[2] Restated. Effective January 1, 2002, CPR was required to adopt retroactively with restatement the new Canadian Institute of Chartered Accountants accounting standard for the treatment of FX on LTD.

Non-recurring Items

In 2002, there was one non-recurring item totalling $72 million resulting from a favourable income tax ruling relating to prior years. In 2001, non-recurring items totalled $25 million ($14 million after tax) in spin-off related and incentive compensation charges, $17 million ($10 million after tax) for bridge financing fees related to the spin-off, and $64 million in income tax rate related recoveries. In 2000, non-recurring items consisted of a $132-million reduction in the future income tax liability associated with a decrease in the Canadian federal income tax rates.

Volumes

Despite the effect on grain volumes of a prolonged Canadian prairie drought, CPR's total traffic volumes decreased only slightly due to its balanced commodity mix. Gross ton-miles ("GTM") in 2002 were 207,810 million, a decrease from record volumes of 211,157 million GTMs generated in 2001 and a decrease from volumes of 210,719 million GTMs in 2000.

year ended December 31 (unaudited)	**2002**	2001	2000
Freight revenues (in millions)			
Grain	**$ 631**	$ 749	$ 755
Coal	**443**	474	388
Sulphur and fertilizers	**401**	381	426
Forest products	**360**	354	366
Industrial products	**422**	431	438
Intermodal	**882**	804	782
Automotive	**333**	304	305
Total freight revenues	**$ 3,472**	$ 3,497	$ 3,460
Carloads (in thousands)			
Grain	**291**	343	351
Coal	**352**	379	315
Sulphur and fertilizers	**174**	170	185
Forest products	**174**	172	179
Industrial products	**272**	276	286
Intermodal	**1,006**	917	904
Automotive	**178**	166	175
Total carloads	**2,447**	2,423	2,395
Revenue ton-miles (in millions)			
Grain	**20,808**	24,785	25,329
Coal	**21,904**	24,229	20,695
Sulphur and fertilizers	**15,737**	14,941	16,169
Forest products	**11,014**	10,684	11,502
Industrial products	**12,801**	13,033	13,349
Intermodal	**22,493**	20,347	20,778
Automotive	**2,932**	2,603	2,587
Total revenue ton-miles	**107,689**	110,622	110,409

REVENUES

Freight revenues in 2002 were $3,472 million, a decrease of $25 million from freight revenues of $3,497 million in 2001. CPR's balanced commodity mix mitigated the impact of the drought-induced drop in Canadian grain revenue and reduced sales of coal by customers. As a result, CPR ended 2002 with a decrease of less than 1 % in freight revenues compared with 2001 and an increase of $12 million over 2000.

Grain

Revenues of $631 million in 2002 were down $118 million from 2001 and down $124 million from 2000. Canadian grain shipments were severely affected by the drought conditions that have prevailed over the Canadian prairies for the last two growing seasons, which reduced production to its lowest level in 25 years. Canadian grain revenues were also adversely affected by a labour disruption at the grain handling facility at the Port of Vancouver. As a result, grain volumes normally shipped directly to the Port of Vancouver were diverted to another carrier at Edmonton, Alberta, resulting in reduced haulage revenue for CPR. An increase in U.S.-originated grain shipments partially offset the challenges in Canada. Strong demand from Canadian prairie feed markets and favourable world market conditions for wheat resulted in increased shipments into Alberta and higher export volumes through the U.S. Pacific Northwest via the joint CPR-Union Pacific Railroad service known as CanAm, which was introduced in 2001.

Coal

Revenues were $443 million in 2002, down $31 million from $474 million in 2001 and up $55 million over $388 million in 2000. Volumes decreased from 2001 due to lower export and North American sales of Canadian metallurgical coal. This was offset partially by increased U.S. coke and thermal coal traffic resulting from new contracts for shipments from CPR's Indiana coal territory to the Wisconsin market.

Sulphur and Fertilizers

Revenues were $401 million in 2002, an improvement of $20 million over $381 million in 2001 and a decline of $25 million from $426 million in 2000. A significant portion of the growth in 2002 was attributable to CPR's market share increase in the export potash transportation business. Chemical fertilizer shipments were marginally weaker in 2002 compared to 2001. As a result of increased demand, revenues from the shipment of sulphur to domestic markets increased year over year. Revenues in 2001 declined from 2000 due to weaker offshore demand for potash, depressed sulphur markets and reduced demand by U.S. phosphate fertilizer producers.

Forest Products

Revenues of $360 million in 2002 were up by $6 million over $354 million in 2001 and down by the same amount from $366 million in 2000. Higher revenues from lumber and pulp were partially offset by reduced shipments of paper and newsprint. An increase in lumber shipments, despite U.S. countervailing duties imposed on Canadian producers, accounted for a significant portion of the gain. Demand for lumber during the year was strong as a result of low interest rates and solid housing demand in Canada and the U.S. Revenues from pulp increased in 2002 stemming from a shift to longer-haul traffic and increased shipments as producers responded to growing demand. A decline in paper and newsprint revenues was largely driven by weak demand for printing paper. In 2002, CPR continued its fleet renewal program, putting its 100-ton boxcar fleet into service. The new cars resulted in increased customer demand due to higher carrying capacity and greater loading and unloading efficiency.

Industrial Products

Revenues of $422 million in 2002 were down $9 million from $431 million in 2001 and down $16 million from $438 million in 2000. Plant closures by CPR customers in 2002 and 2001 had a negative impact on revenues in both years. Most notable was 3M Company's closure of its roofing granule plant in Ontario in 2002 and the mid-2001 closure of Methanex Corporation's methanol plant in Alberta. Revenues in 2002 also decreased as a result of reduced frac sand shipments due to lower oil and gas drilling activity in Alberta, soft steel demand and a decrease in CPR's glycol and styrene transportation business.

Intermodal

Revenues of $882 million in 2002 exceeded 2001 revenues of $804 million by $78 million and exceeded 2000 revenues of $782 million by $100 million. Improved revenues were realized across all sectors of CPR's intermodal portfolio. In the domestic market, growth in the retail and consumer segments was driven by higher traffic volumes from long-term major customers Hudson's Bay Company, Zellers Inc., Canadian Tire Corporation, Limited and Consolidated Fastfrate, Inc. Westfair Foods Ltd., a new customer, continued to consolidate its warehousing and distribution facilities with CPR, and its strong retail sales translated into increased CPR revenues. CPR's import-export business experienced very strong revenue growth during 2002. Traffic flows through both the Port of Vancouver and the Port of Montreal were up significantly, supported by strong consumer demand. Volumes also increased due to the diversion of cargo from U.S. West Coast ports, new accounts and growth in CPR's Chicago and U.S. Northeast corridors.

Automotive

Revenues for 2002 were $333 million, up $29 million over $304 million in 2001 and $28 million over $305 million in 2000. Consumers, motivated by dealer incentives and the introduction of several new models, increased demand for vehicles. During 2002, CPR developed new DaimlerChrysler business, shipping from St. Louis and Mexico into Eastern Canada, and new Ford business, shipping from Chicago to Vancouver. Other contributions to the strong performance in this sector included production increases at Ford's St. Paul facility, strong General Motors production in Mexico, and the expansion of Toyota's Cambridge, Ontario facility.

Other Revenues

Other revenues for the year ended December 31, 2002, were $194 million, a decrease of $8 million from 2001 and a decline of $1 million from 2000. Other revenues were derived mainly from switching fees, building rentals and gains on sales of real estate.

PERFORMANCE INDICATORS

year ended December 31	**2002**	2001	2000
Gross ton-miles (GTM) of freight (millions)	**207,810**	211,157	210,719
Freight revenue per revenue ton-mile (cents)	**3.22**	3.16	3.13
Total operating expenses per train-mile (dollars) [1]	**73.35**	74.88	71.83
Average number of active employees [2]	**16,116**	16,987	17,965
Miles of road operated at end of period [3]	**13,874**	13,893	13,959
GTMs per active locomotive per day (thousands)	**665**	672	646
GTMs per mile of road operated (thousands) [3]	**14,978**	15,199	15,096
GTMs per average active employee (thousands)	**12,895**	12,431	11,729
Average train weights (tons)	**5,426**	5,533	5,386
U.S. gallons of fuel per thousand GTMs	**1.25**	1.26	1.30
FRA personal injuries per 200,000 employee-hours	**3.6**	3.9 [4]	3.9
FRA train accidents per million train-miles	**1.8**	2.0 [4]	2.0

[1] Excluding non-recurring items.
[2] Average of active employees at end of each month.
[3] Excluding track on which CPR has haulage rights.
[4] Restated.

Operating Expenses
The overall reduction in operating expenses can be attributed to productivity improvement measures put in place during the year. Productivity, measured in employee workload and freight car utilization, was at an all-time high.

OPERATING EXPENSES, EXCLUDING NON-RECURRING ITEMS [1][2]

(in millions)	**fiscal 2002**	**% of revenue**	fiscal 2001	% of revenue	fiscal 2000	% of revenue
Compensation and benefits	**$ 1,131**	**30.8 %**	$ 1,122	30.3 %	$ 1,148	31.4 %
Fuel	**358**	**9.8**	403	10.9	410	11.2
Materials	**166**	**4.5**	181	4.9	213	5.8
Equipment rents	**255**	**7.0**	272	7.4	267	7.3
Depreciation and amortization	**348**	**9.5**	335	9.1	305	8.4
Purchased services and other	**551**	**15.0**	545	14.7	467	12.8
Total, excluding non-recurring items [1] [2]	**$ 2,809**	**76.6 %**	$ 2,858	77.3 %	$ 2,810	76.9 %

[1] Excludes non-recurring items, which are described under the heading Non-Recurring Items in this MD&A.
[2] For a reconciliation, see Reconciliation of Non-GAAP Earnings to GAAP Earnings under the heading Operating Results in this MD&A.

Compensation and Benefits

Expenses were $1,131 million in 2002, up from $1,122 million in 2001 and down from $1,148 million in 2000. In 2002, CPR's average number of active employees was 16,116, down from 16,987 employees in 2001 and 17,965 in 2000. The increase in compensation and benefits expenses in 2002 compared to 2001 resulted mainly from increased expenses for fringe benefits, inflation and an employee share purchase plan implemented in fourth-quarter 2001. Cost savings resulting from workforce reductions during 2002 and 2001 largely offset these increases. The decrease in compensation and benefits expenses in 2001 was due to workforce reductions and lower variable incentive compensation, which were partially offset by inflationary rate increases.

Fuel

Expenses were $358 million in 2002, down from $403 million in 2001 and $410 million in 2000. The decrease in 2002 from 2001 was largely due to lower fuel prices, a successful hedging program and consumption efficiency gains. The decrease in 2001 compared to 2000 resulted from efficiency gains and a drop in fuel prices. A sensitivity analysis indicated that a change in the crude oil price (West Texas Intermediate) of US$1 results in a change of approximately CDN$10 million on CPR's operating income, before any offsetting impact from CPR's fuel hedging program.

Materials, Purchased Services and Other

Expenses were $717 million in 2002, down from $726 million in 2001 and up from $680 million in 2000. For 2002 compared to 2001, initiative savings and lower locomotive maintenance expenses more than offset increased insurance and other expenses. Repair expenses incurred during harsh winter weather and flooding in the first half of 2001 contributed significantly to the 2001 increase over 2000.

Equipment Rents

Expenses decreased to $255 million in 2002 from $272 million in 2001 and $267 million in 2000. The decrease in 2002 from 2001 reflected the impact of improved asset utilization and other initiatives, which more than offset higher car hire payments as a result of increased non-bulk traffic. Expenses in 2001 increased over expenses in 2000 due to volume growth in coal and domestic intermodal traffic. Lower car hire receipts in 2001 also contributed to the increase in equipment rents expenses compared to the previous year.

Depreciation and Amortization

Expenses in 2002 increased to $348 million from $335 million in 2001 and from $305 million in 2000. The increase in 2002 compared to 2001 resulted from ongoing capital additions, partially offset by the favourable impact of depreciation rate revisions. CPR's increased asset base, along with a change in mix of assets largely due to an increase in information technology assets, were the principal reasons for the rise in depreciation expenses in 2001 compared with 2000.

OTHER INCOME STATEMENT ITEMS

Other Charges

Other charges were $22 million in 2002, down from $26 million in 2001 and up slightly from $21 million in 2000. During the first quarter of 2002, CPR incurred charges of $17.5 million related to the early redemption of its 8.85 % Debentures, along with $2.5 million of accelerated amortization of deferred financing charges. This was offset by interest received pertaining to a favourable income tax ruling of approximately $27 million related to prior years.

Interest Expense

Interest expense, net of interest income, increased to $242 million on net debt of $3,038 million in 2002, up from $210 million on net debt of $3,190 million in 2001 and up from $167 million on net debt of $2,209 million in 2000. The increase in 2002 reflected the full-year impact of CPR's new capital structure and increased debt following the spin-off from CPL, partially mitigated by the early redemption of CPR's 8.85 % Debentures.

Income Taxes

During 2002, the Company reported an after-tax recovery of income taxes of approximately $72 million resulting from a favourable tax decision of the Federal Court of Appeal. This resulted in an overall effective tax rate of 18 % for 2002, compared with a normalized rate for the year of approximately 31 %.

Income taxes in 2000 decreased when the Canadian federal government announced a 7 % reduction in the corporate tax rate for certain industry sectors to be phased in over a four-year period. In accordance with the accounting standards required by the Canadian Institute of Chartered Accountants ("CICA"), the anticipated benefit on future income taxes of $132 million was immediately recognized, resulting in a lower effective tax rate of 20 % in 2000. The normalized tax rate for 2000, excluding this impact, was approximately 38 %.

Along with similar corporate future tax rate reductions instituted by various provincial governments in 2001 and a reduction in the apportioned provincial tax rate caused by the amalgamation on January 1, 2001, of Canadian Pacific Railway Company and its Canadian subsidiary, St. Lawrence & Hudson Railway Company Limited, CPR recognized a $64-million decrease in future income tax expense in 2001. This resulted in an effective tax rate of 26 % for 2001, as compared to a normalized rate for the year of approximately 37 %.

FOURTH-QUARTER 2002

Revenues were $950 million for the fourth quarter of 2002, virtually unchanged from $951 million in fourth-quarter 2001. Grain revenues for the fourth quarter of 2002 were $162 million, down 18 % from $197 million in the same period of 2001 as a result of depressed grain shipments due to the Canadian prairie drought. Coal revenues were $103 million, down 16 % from $123 million in the same period of 2001, reflecting reduced shipments by mining customers. These decreases were largely offset by an 18 % increase in domestic and import-export intermodal transportation revenues to $237 million in the fourth quarter of 2002, from $201 million in the same period of 2001 due to an increase in intermodal transportation volumes. Automotive transportation revenues were $89 million, up 14 % over fourth-quarter 2001 revenues of $78 million due to strong demand for automobiles. Industrial products transportation revenues were up more than 6 % to $109 million in the fourth quarter of 2002 from $102 million in the same quarter of 2001 as an expected last-quarter rebound materialized. Sulphur and fertilizers transportation revenues were $99 million in the fourth quarter of 2002, up 9 % over $91 million in the same quarter of 2001 as the domestic market for sulphur continued to improve through the last three months of 2002 and CPR gained market share of exports. Fourth-quarter 2002 results included a foreign exchange gain on long-term debt of $6 million ($6 million after tax).

Operating expenses for the fourth quarter of 2002 were $712 million, up 3 % compared with the same period of 2001, excluding non-recurring items in fourth-quarter 2001. Purchased services and other expenses were $148 million, up 11 % over $133 million in the same period of 2001, partly as a result of higher insurance costs and timing of expenses. Compensation and

benefits expenses increased 5 % to $280 million compared with $268 million in the fourth quarter of 2001, largely due to incentive-based compensation and CPR's employee share purchase program. Depreciation and amortization expenses were up 3 % to $88 million compared with $85 million in the fourth quarter of 2001 due to investments in new assets. Fuel expenses were flat, as CPR's hedging program offset higher fuel prices. Equipment rents expenses were down 3 % to $62 million in the fourth quarter of 2002 from $64 million in the fourth quarter of 2001.

CHANGES IN ACCOUNTING POLICY

Changes in accounting policy are discussed in detail in Note 3 of the Notes to Consolidated Financial Statements included in this Annual Report.

LIQUIDITY AND CAPITAL RESOURCES

CPR believes that adequate amounts of cash and cash equivalents are available in both the short term and the long term to provide for ongoing operations and planned growth. CPR is not aware of any trends or expected fluctuations in CPR's liquidity that would create any deficiencies. The following discussion of operating, investing and financing activities describes CPR's indicators of liquidity and capital resources.

Operating Activities

Cash provided by operating activities during 2002 was $784 million, up $25 million over 2001 and up $107 million over 2000.

During 2002, CPR began new restructuring initiatives to reduce costs by eliminating 85 positions. The reductions occurred mostly in administrative areas. These initiatives required an increase to the restructuring provision of $7 million. This change was offset by a net reduction of $3.9 million of previously accrued restructuring initiatives due to net experience gains and a present value discount adjustment of $2 million due to a delay in expected payments.

At December 31, 2002, employee reductions related to all restructuring initiatives were substantially complete. However, employment security, bridging and early retirement payments related to these reductions will continue into future years.

Cash payments in 2002 related to severance under all restructuring initiatives and CPR's environmental remediation program, described under Critical Accounting Estimates in this MD&A, amounted to $119 million, compared with $132 million in 2001 and $163 million in 2000. The total accrued restructuring and environmental liability at December 31, 2002, was $442 million, of which $130 million is included in current liabilities.

There are no specific or unusual requirements relating to CPR's working capital. In addition, there are no unusual restrictions on any subsidiary's ability to transfer funds to CPR, as required.

Investing Activities

Cash used in investing activities during 2002 was $572 million, a decrease of $18 million from 2001 and an increase of $35 million over 2000. The decrease from 2001 is attributable to slightly lower capital spending, as well as higher track-related salvage proceeds. The increase over 2000 is largely due to higher proceeds from disposal of transportation properties, which included the sale of the Toronto Terminal Railway and Weston Shops.

Financing Activities

Cash used in financing activities in 2002 was $484 million, compared with cash provided by financing activities of $268 million in 2001 and cash used in financing activities of $59 million in 2000. The increase of $752 million over 2001 is primarily attributable

to the early redemption in June 2002 of CPR's 8.85 % Debentures due 2022, compared to the issuance of approximately $1.2 billion of long-term debt in the fourth quarter of 2001, which was only partially offset by a return of capital ($700 million) to CPL and by other spin-off related settlements with former affiliates.

During 2002, CPR's net-debt to net-debt-plus-equity ratio improved to 47.3 %, compared with 51.8 % in 2001. CPR's net-debt to net-debt-plus-equity ratio was 39.1 % in 2000 prior to the restructuring of capital as part of CPR's spin-off from CPL. Net debt is the sum of long-term debt and long-term debt maturing within one year, less cash and short-term investments.

CPR has available, as sources of financing, credit facilities of up to $666 million. CPR believes it can raise capital in excess of these amounts, if required, while maintaining its credit quality in international debt markets. CPR's unsecured long-term debt securities are rated "Baa2", "BBB" and "BBB" by Moody's Investors Service, Inc., Standard and Poor's Corporation and Dominion Bond Rating Service, respectively.

Balance Sheet

Assets totalled $9,661 million at December 31, 2002, unchanged from the total at December 31, 2001, and increased from $8,658 million at December 31, 2000. In 2002, capital additions to net properties were offset by a decrease in cash held in temporary investments. The increase over 2000 was due to capital additions to net properties and an increase in cash held in temporary investments.

The following table indicates CPR's known contractual obligations and commitments to make future payments under contracts such as debt, lease arrangements and commercial commitments at December 31, 2002:

SUMMARY OF CONTRACTUAL OBLIGATIONS AND COMMITMENTS

(in millions)			payments due by period		
liabilities at December 31, 2002, reflected on the balance sheet	total	2003	2004 & 2005	2006 & 2007	after 2007
Long-term debt	$ 2,873	$ 397	$ 263	$ 30	$ 2,183
Capital lease obligations	450	4	11	19	416
Total contractual obligations	$ 3,323	$ 401	$ 274	$ 49	$ 2,599

(in millions)			amount of commitment and contingencies per period		
other commitments and contingencies on future operating income	total	2003	2004 & 2005	2006 & 2007	after 2007
Supplier purchase obligations	$ 1,063	$ 240	$ 207	$ 196	$ 420
Operating leases [1]	486	132	197	120	37
Letters of credit	211	211	–	–	–
Capital commitments	197	192	3	2	–
Sale of accounts receivable	120	120	–	–	–
Surety bonds	116	116	–	–	–
Interest rate locks on long-term debt – unrealized loss	14	14	–	–	–
Forward foreign currency contracts – unrealized gain	(1)	(1)	–	–	–
Crude oil futures – unrealized gain	(26)	(19)	(6)	(1)	–
Total commitments and contingencies	$ 2,180	$ 1,005	$ 401	$ 317	$ 457

[1] CPR has guaranteed residual values on certain leased equipment with a maximum exposure of $212 million in 2006 and beyond. Based on independent appraisals, management estimates that CPR will have no net payments under these residual guarantees and, as such, has not included any amounts with respect to these guaranteed residual values in the minimum payments shown above.

FINANCIAL INSTRUMENTS

The Company's policy is to not utilize derivative financial and commodity instruments for trading or speculative purposes. CPR's policy with respect to hedging of risk exposure is to selectively reduce volatility associated with variable interest rate loans, foreign exchange fluctuations and fluctuations in the price of diesel fuel. A portion of the U.S. dollar denominated long-term debt has been designated as a hedge of the net investment in self-sustaining foreign subsidiaries. Unrealized foreign exchange gains and losses on a portion of the U.S. dollar denominated long-term debt is offset against foreign exchange gains and losses arising from translation of self-sustaining foreign subsidiaries' accounts. Financial instruments are discussed in detail in Note 2 and Note 14 of the Notes to Consolidated Financial Statements included in this Annual Report.

BUSINESS RISKS AND CRITICAL ACCOUNTING ESTIMATES

Future Trends, Commitments and Risks

In 2003, CPR will continue its focus on revenue growth and cost reduction as well as improved utilization of its asset base. Revenue growth initiatives currently under way are aimed at enhancing yield and further developing the intermodal and carload businesses. These initiatives include Connetix,

which uses truck-rail transfer facilities to provide shippers access to rail service, and Expressway, through which CPR provides high-quality intermodal services in the short-haul market between Montreal, Toronto and Detroit. Expressway works in partnership with the trucking industry as the only modern train service capable of handling non-reinforced truck trailers. CPR anticipates continued gains in the domestic intermodal and import-export sectors, assuming ongoing growth in the North American economy. In addition, Tronicus Inc., a CPR subsidiary, provides integrated and customized supply chain management solutions for both rail and non-rail customers.

Continuing cost containment programs are seen as vital to CPR achieving its financial performance targets. In 2002, CPR's average number of active employees was down compared with 2001 and 2000. This was primarily due to new and previously announced cost-reduction initiatives which resulted in the elimination of over 400 positions. In addition, 2002 reflected the full year's benefit from transferring approximately 600 positions in 2001 to suppliers providing fleet maintenance services. These job eliminations and transfers resulted in improved asset utilization and rationalization of administrative functions. Through ongoing productivity improvements, employment levels should remain fairly stable in 2003, as future increases in workload are expected to be absorbed, to the extent possible, using the existing workforce.

Improved asset utilization is expected to result from further railcar modernization and from recent investments in information technology. Overall, the rail industry is continuing to leverage its information technology to facilitate its dealings with suppliers and shippers. CPR's ongoing strategy is to strategically apply selected information technology to improve its competitive position.

CPR remains committed to maintaining its current high level of plant quality and renewing its franchise. At December 31, 2002, CPR had committed to future capital expenditures amounting to $197 million, which is expected to be financed by cash generated from operations. With respect to existing operating lease commitments, minimum lease payments in 2003 will total $132 million. Minimum payments under operating leases are currently estimated at $486 million in aggregate over the next 10 years.

CPR has a substantial investment in fixed plant and equipment, and limited flexibility to adjust output levels and expenditures in response to short-term declines in traffic, potentially resulting in a cyclical adverse impact on future earnings levels. However, CPR actively manages its processes and resources to control variable costs, increase efficiency and mitigate the negative effects of declines in freight traffic.

Management is committed to maintaining its net-debt to net-debt-plus-equity ratio at an acceptable level and will continue to seek lower-cost term financing to fund its capital commitments and other borrowing requirements so that the Company retains solid investment-grade credit.

CPR's traffic volumes and revenues are largely dependent upon the health and growth of the North American and global economies, exchange rates, and other factors affecting the volume and patterns of international trade. CPR's future grain transportation revenues may be negatively affected if conditions that existed in its grain collection areas in 2002 persist in 2003. CPR will attempt to mitigate the effects of any downward pressure on transportation revenues primarily through cost-containment measures. As well, any reduction in grain revenues due to drought may be partially offset in 2003 by expected revenue growth in other sectors of CPR's business, such as intermodal, sulphur and fertilizers, forest products and industrial products.

Oil prices, which increased during the latter half of 2002, escalated further in early 2003 and remain an uncertainty due

to political unrest and a threat of military conflict in the Middle East. CPR will continue to mitigate any increases in fuel prices mainly through its fuel hedging programs and fuel efficiency initiatives.

As a consequence of terrorist attacks in the U.S. in 2001, some security issues involving the movement of goods across the Canada-U.S. border remain to be resolved. No significant disruptions to CPR's cross-border rail service have occurred since the September 11, 2001, terrorist incidents. Nonetheless, CPR continues to be involved in discussions with other railways and the Canadian and U.S. governments in an ongoing effort to ensure that the movement of goods by rail across the border is not unduly hindered by security measures. In the U.S., CPR has applied for certification under Customs Service's Customs-Trade Partnership Against Terrorism ("C-TPAT"), a joint government-private industry initiative that offers businesses an opportunity to play an active role in countering terrorism and builds cooperative relationships to strengthen overall supply chain and border security. As a signatory to the U.S. Carrier Initiative Program, CPR is also working with the U.S. Customs Service to halt the smuggling of drugs. In Canada, CPR is in the process of joining the Canada Customs and Revenue Agency's Partners in Protection program which, like C-TPAT, protects trade supply chains from criminal elements. CPR has also been approved under a new Canada Customs and Revenue Agency program to streamline clearance at the Canada-U.S. border for certain approved low-risk goods being imported into Canada from the U.S.

New rules governing U.S. rail mergers that were implemented in 2001 will likely result in increased scrutiny by the U.S. Surface Transportation Board ("STB") of proposed railway mergers and have broadened the scope of competition-enhancing conditions that the STB may impose in connection with such mergers. Any future merger activity among North American railways might affect CPR's competitive position; however, detrimental effects may be mitigated by CPR's increasing participation in operational and commercial alliances.

In Canada, the ongoing review of the *Canada Transportation Act* ("CTA") may result in amendments that could affect the competitive capability and commercial strategies of Canadian railways. While it is not possible to predict the outcome of the review, the final report issued in July 2001 expressly recognized that to compete internationally, Canada requires a viable, sustainable rail industry. It is expected that this philosophy will serve as a framework for any future changes in the law.

On January 1, 2002, CPR completed a pension valuation for the three-year period ending December 31, 2004. CPR contributed $54 million in 2002 to its employee pension plans. The results of the survey, based on estimated payroll, indicated that CPR expects to contribute approximately $56 million in 2003 and $58 million in 2004. Since it is not possible to predict future plan experience and long-term interest rates, contribution requirements beyond December 31, 2004, may differ substantially from the current level.

CRITICAL ACCOUNTING ESTIMATES

To prepare financial statements in conformity with Canadian GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Management reviews its estimates on an ongoing basis, including those related to environmental liabilities, pensions and other benefits, property, plant

and equipment, future income taxes and legal and personal injury liabilities, using the most current information available.

The development, selection and disclosure of these estimates as well as this MD&A have been reviewed with the Audit, Finance and Risk Management Committee of the Board of Directors.

Environmental Liabilities
Management estimates the probable costs to be incurred in the remediation of property sites contaminated by past railway use. Sites are screened and classified according to typical activities and scale of operations conducted, and remediation strategies are developed for each property based on the nature and extent of the contamination as well as the location of the property and surrounding areas that may be adversely affected by the presence of contaminants. Management also considers available technologies, treatment and disposal facilities and the acceptability of site-specific plans based on the local regulatory environment. Site-specific plans range from containment and risk management of the contaminants through to the removal and treatment of the contaminant and affected soils and ground water. The details of the estimates reflect the environmental liability at each property. CPR is committed to fully meeting its regulatory and legal obligations with respect to environmental matters.

In 1995, after conducting environmental investigations at various properties for several years across Canada and the U.S., CPR recorded a before-tax environmental provision of $144 million for 10 years of a program to manage environmental liabilities from historical operations. This provision was increased by an additional $50 million in 1999, at which time the net amount accrued, after payments, was $164 million.

ENVIRONMENTAL REMEDIATION ACCRUAL

(in millions)	
Opening balance at January 1, 2000	$ 164
Payments, net of adjustments to accruals during 2000	(16)
Payments, net of adjustments to accruals during 2001	(15)
Payments, net of adjustments to accruals during 2002	(18)
Accrual balance at December 31, 2002	$ 115

At December 31, 2002, the accrual for environmental remediation amounted to $115 million, of which the long-term portion amounting to $88 million was included in deferred liabilities and the short-term portion amounting to $27 million was included in accrued liabilities. Costs incurred under the environmental remediation program are charged against the accrual.

Liability projections assume government regulations will not change significantly over the 10-year period. Liability projections also assume the Company will continue operating as a railway and has developed its environmental remediation strategies accordingly.

Pensions and Other Benefits
CPR has post-employment benefit plans, including defined benefit pension plans and other post-retirement benefit plans, that involve the use of certain key estimates, as described in the following table:

key estimates	description	annual rate	comments
Expected rate of return on fund assets	Represents the expected long-term rate of return earned on plan assets; impacts pension expense since asset return is an offset to the current service cost and interest on liabilities	8 %	The rate chosen is based on long-term asset mix strategy and long-term market outlook
Inflation rate/ projected salary increases	Projected salary increases refer to salaries of current CPR employees; these estimates impact pension benefit obligations and pension expenses by affecting the estimated level of future salaries and inflation-related pension indexation, which in turn affect future benefit levels	2.5 %/ 3 %	Inflation and salary increases are based on long-term market outlook
Projected health care cost trend rate	Represents the expected future cost of post-retirement health care benefits	6.9 % (1)	The rates chosen reflect expected increases in post-retirement health care costs

(1) In Canada, 6.9 % in 2002, reducing by 0.6 % per year to an annual increase of 4.5 % per year; 10.5 % in the U.S., decreasing to 5 % by 2013 (the U.S. post-retirement benefits liability is about one-third the size of that in Canada).

In order to reduce volatility associated with its defined benefit pensions and other benefits, CPR's methodology uses:

a) a 10 % corridor for experience gains and losses; the unrecognized actuarial gains and losses in excess of 10 % of the greater of the benefit obligation and the market-related value of plan assets are amortized over the Employees' Average Remaining Service Lifetime ("EARSL") of active employees expected to receive benefits under the plan;

b) market-related values of plan assets using an average of fair values over a period of up to five years; and

c) an EARSL of 12 years for the amortization of applicable amounts into annual expense.

SENSITIVITY OF PENSIONS AND OTHER BENEFITS

estimate	sensitivity change from assumptions (percentage points)	impact on annual expense – favourable (unfavourable) $ millions	impact on funded status – favourable (unfavourable) $ millions
Expected rate of return on fund assets	+0.5 to –0.5	27 to (27)	–
Inflation rate	+0.5 to –0.5	(10) to 9	(122) to 123
Salary increases	+0.5 to –0.5	(9) to 9	(71) to 73
Projected health care cost trend rate	+0.5 to –0.5	(1) to 1	(5) to 5

Pensions and other benefits expenses are included in the Compensation and Benefits line in the income statement. For the year ended December 31, 2002, pension income was $2 million, consisting of defined benefit pension income of $5 million and defined contribution pension expense (equal to contributions) of $3 million. Other post-retirement benefits expenses were $54 million, resulting in combined pension and other post-retirement benefits expenses of $52 million. Prepaid pension costs are included in other assets and deferred charges and amounted to $336 million at December 31, 2002. Other post-retirement benefits of $110 million are included in deferred liabilities at December 31, 2002.

There have been no changes in the past three years that have had a material effect on the estimate assumptions for pensions and other post-retirement benefits.

Property, Plant and Equipment

CPR follows the group depreciation method and depreciates the cost of properties, net of salvage, on a straight-line basis over the estimated useful life of the property group.

CPR undertakes regular depreciation studies to establish the estimated useful life of each property group. These studies establish the weighted average estimated useful life by property group, taking into consideration current and historical information about the asset lives. Considerations include but are not limited to: historical useful lives of similar assets; historical incidence of early retirements (e.g. as a result of train accidents); anticipated future uses of assets; and net salvage values at retirement. Regulatory standards in Canada require depreciation studies to be completed and submitted for approval at least every seven years. Standards in the U.S. require studies to be completed and submitted for approval every three years for equipment and every six years for track.

The estimated useful lives of properties have a direct impact on the amount of depreciation expense charged by the Company and the amount of accumulated depreciation recorded as a component of Net Properties on the balance sheet. For the year ended December 31, 2002, depreciation expense relating to properties amounted to $348 million, and at December 31, 2002, accumulated depreciation was $4,172 million.

Revisions to the estimated useful lives of properties constitute a change in accounting estimate and are dealt with prospectively by amending depreciation rates. It is anticipated that there will be minor changes in the weighted average useful life of each property group as assets are acquired, used and retired. While a significant change in the useful lives of properties could result in a material change to depreciation expenses, no such change is currently anticipated.

CPR completed a depreciation study of certain properties in 2002, resulting in changes to the estimated useful lives of certain assets. The impact of these changes decreased depreciation expenses by $21 million, with an equivalent reduction in accumulated depreciation.

Future Income Taxes

Effective January 1, 2001, CPR adopted CICA Section 3465 "Income Taxes" with respect to the accounting of future income taxes, which is based on the liability method. This method focuses on the balance sheet of the company and the temporary differences otherwise calculated from the comparison of book versus tax values. It is assumed that such temporary differences will be settled in the future at the substantively enacted tax rates. This valuation process determines the future income tax assets and liabilities at the balance sheet date.

Management is required to estimate the timing of the realization and settlement of future income tax assets (including the benefit of tax losses) and liabilities. The substantively enacted federal and provincial future income tax

rates may differ in each future period. The timing and realization of future income taxes at the balance sheet date are determined with reference to management's long-term income and capital investment forecasts developed as part of the Company's planning and budgeting processes.

Future income tax expenses totalling $99 million were included in income taxes for 2002. Future income tax liabilities of $1,200 million were recorded at December 31, 2002, as a long-term liability, comprised largely of temporary differences related to accounting for properties. Future income tax benefits of $73 million realizable within one year were recorded as a current asset.

With the passage of legislation to reduce federal income tax rates by 7 % over time, CPR recorded a $132-million reduction of future income tax liabilities in 2000. During 2001, CPR recorded a further $45-million reduction of future income tax liabilities on substantively enacted reduced provincial tax rates.

Legal and Personal Injury Liabilities

CPR and its subsidiaries are involved in litigation in both Canada and the U.S. related to their businesses. Management is required to establish estimates of potential liability arising from incidents, claims and pending litigation, including personal injury claims, certain occupation-related claims and claims relating to property damage.

These estimates are determined on a case-by-case basis. They are based on CPR's assessment of the actual damages incurred, current legal advice with respect to the expected outcome of the legal action, and actuarially-determined assessments with respect to settlements in other similar cases. CPR employs experienced claims adjusters who investigate and assess the validity of individual claims made against the Company and estimate the damages incurred.

A provision for incidents, claims or litigation is recorded, based on the facts and circumstances known at the time. CPR accrues for likely claims when the facts of an incident become known and investigation results provide a reasonable basis for estimating the liability. The lower end of the range is accrued if the facts and circumstances permit only a range of reasonable estimates and no single amount in that range is a better estimate than any other. Additionally, for administrative expediency, the Company keeps a general provision for lesser-value injury cases. Facts and circumstances related to asserted claims can change, and a process is in place to monitor accruals for changes in accounting estimates.

With respect to claims related to occupational health and safety in the provinces of Quebec, Ontario, Manitoba and British Columbia, estimates administered through the Workers' Compensation Board ("WCB") are actuarially determined. In the provinces of Saskatchewan and Alberta, CPR is assessed for an annual WCB contribution. As a result, this amount is not subject to estimation by management.

Railway employees in the U.S. are not covered by a workers' compensation program. CPR manages workers' compensation claims in the U.S. using a case-by-case comprehensive approach, rather than the statistical estimate approach used by some Class I railways.

The incidence of claims related to occupational health and safety in the U.S. has increased in recent years. However, the impact of this increase is not material and has already been reflected in management's assessment of claims and related provisions.

Provisions for incidents, claims and litigation charged to income are included in Purchased Services and Other on CPR's income statement and amounted to $69 million for the year ended December 31, 2002. Accruals for incidents, claims and litigation totalled $173 million, net of insurance recoveries, at December 31, 2002, and are included in Accounts Payable and Accrued Liabilities.

FORWARD-LOOKING INFORMATION

This Annual Report contains certain forward-looking statements within the meaning of the *Private Securities Litigation Reform Act of 1995* (United States) relating but not limited to CPR's operations, anticipated financial performance, business prospects and strategies. Forward-looking information typically contains statements with words such as "anticipate", "believe", "expect", "plan" or similar words suggesting future outcomes. Much of this information appears in the MD&A.

Readers are cautioned to not place undue reliance on forward-looking information because it is possible that predictions, forecasts, projections, and other forms of forward-looking information will not be achieved by CPR. In addition, CPR undertakes no obligation to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

By its nature, CPR's forward-looking information involves numerous assumptions, inherent risks and uncertainties, including but not limited to the following factors: changes in business strategies; general global economic and business conditions; the availability and price of energy commodities; the effects of competition and pricing pressures; industry overcapacity; shifts in market demands; changes in laws and regulations, including environmental and regulatory laws; potential increases in maintenance and operating costs; uncertainties of litigation; labour disputes; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; various events which could disrupt operations, including severe weather conditions; and technological changes.

The performance of the North American and global economies was uncertain in 2002 and remains uncertain in 2003. The drought conditions that affected some grain producing areas in North America in 2002 may persist in 2003. Fuel prices also remain uncertain in 2003, particularly in light of continuing political unrest and a threat of military conflict in the Middle East. Fuel prices are affected by many factors, including worldwide oil demand, international politics, and the ability of major oil producing countries to comply with agreed upon production quotas.

There is also continuing uncertainty with respect to security issues involving the movement of goods in populous areas of the U.S. and Canada and the protection of North America's rail infrastructure, including the movement of goods across the Canada-U.S. border.

In the competitive environment, new rules governing railway mergers were established by the STB in 2001. The new rules have broadened the scope of competition-enhancing conditions that the STB may impose in connection with railway mergers and will likely result in increased scrutiny by the STB of proposed railway mergers.

In Canada, the ongoing review of the CTA may result in amendments that could affect the competitive capability and commercial strategies of Canadian railways. While it is not possible to predict the outcome of the review, the final report issued in July 2001 expressly recognized that to compete internationally, Canada requires a viable, sustainable rail industry.

In addition to the foregoing general factors, there are more specific factors that could cause actual results to differ from those described in the forward-looking statements contained in this Annual Report. These more specific factors are identified and discussed elsewhere in this MD&A with the particular forward-looking statement in question.

QUARTERLY FINANCIAL DATA (UNAUDITED)

(in millions, except per share data)	Dec. 31	Sept. 30	June 30	March 31
2002				
Total revenue	**$ 950.4**	**$ 917.3**	**$ 922.5**	**$ 875.4**
Operating income	**$ 238.0**	**$ 223.6**	**$ 219.0**	**$ 175.9**
Net income	**$ 125.6**	**$ 65.3**	**$ 168.7**	**$ 136.4**
Basic earnings per share	**$ 0.79**	**$ 0.41**	**$ 1.06**	**$ 0.86**
Diluted earnings per share	**$ 0.79**	**$ 0.41**	**$ 1.06**	**$ 0.86**
2001[1]				
Total revenue	$ 950.7	$ 898.2	$ 931.4	$ 918.3
Operating income	$ 259.8	$ 214.7	$ 205.6	$ 136.4
Net income	$ 97.7	$ 114.7	$ 125.3	$ 34.8
Basic earnings per share	$ 0.62	$ 0.72	$ 0.79	$ 0.22
Diluted earnings per share	$ 0.61	$ 0.72	$ 0.79	$ 0.22

[1] Restated. Effective January 1, 2002, CPR was required to adopt retroactively with restatement the new Canadian Institute of Chartered Accountants accounting standard for the treatment of FX on LTD.

The information in this Annual Report is the responsibility of management. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include some amounts based on management's best estimates and careful judgment.

Management maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded and that transactions are authorized, recorded and reported properly. The internal audit department reviews these accounting controls on an ongoing basis and reports its findings and recommendations to management and the Audit, Finance and Risk Management Committee of the Board of Directors.

The Board of Directors carries out its responsibility for the consolidated financial statements principally through its Audit, Finance and Risk Management Committee, consisting of five members, all of whom are outside directors. This Committee reviews the consolidated financial statements with management and the independent auditors prior to submission to the Board for approval. It also reviews the recommendations of both the independent and internal auditors for improvements to internal controls, as well as the actions of management to implement such recommendations.

Michael T. Waites
Executive Vice-President and Chief Financial Officer

Robert J. Ritchie
President and Chief Executive Officer

February 18, 2003

To the Shareholders of Canadian Pacific Railway Limited

We have audited the consolidated balance sheets of Canadian Pacific Railway Limited as at December 31, 2002 and 2001, and the consolidated statements of income, retained income and cash flows for each of the three years in the period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of Canadian Pacific Railway Limited as at December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in accordance with generally accepted accounting principles in Canada.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
Calgary, Alberta

February 18, 2003

COMMENTS BY AUDITORS FOR U.S. READERS ON CANADA–U.S. REPORTING DIFFERENCE

In the United States, reporting standards for auditors require the addition of an explanatory paragraph (following the opinion paragraph) when there is a change in accounting principles that has a material effect on the comparability of the Company's financial statements, such as the change described in Note 3 to the consolidated financial statements. Our report to the shareholders dated February 18, 2003, is expressed in accordance with Canadian reporting standards which do not require a reference to such a change in accounting principles in the Auditors' Report when the change is properly accounted for and adequately disclosed in the financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
Calgary, Alberta

February 18, 2003

STATEMENT OF CONSOLIDATED INCOME

year ended December 31 (in millions, except per share data)	**2002**	2001	2000
Revenues			
Freight	**$ 3,471.9**	$ 3,496.7	$ 3,460.1
Other	**193.7**	201.9	195.0
	3,665.6	3,698.6	3,655.1
Operating expenses			
Compensation and benefits	**1,131.1**	1,122.1	1,147.8
Fuel	**357.5**	403.0	409.7
Materials	**165.7**	180.9	213.3
Equipment rents	**255.0**	272.1	266.7
Depreciation and amortization	**348.4**	334.4	304.7
Purchased services and other	**551.4**	545.1	467.7
	2,809.1	2,857.6	2,809.9
Operating income before the following:	**856.5**	841.0	845.2
Spin-off related, incentive compensation and unusual charges	**–**	24.5	–
Operating income	**856.5**	816.5	845.2
Other charges (Note 4)	**21.8**	26.4	21.0
Foreign exchange (gain) loss on long-term debt	**(13.4)**	58.2	32.1
Bridge financing fees related to spin-off	**–**	17.2	–
Interest expense (Note 5)	**242.2**	209.6	167.0
Income tax expense (Note 6)	**109.9**	132.6	122.5
Net income	**$ 496.0**	$ 372.5	$ 502.6
Basic earnings per share (Note 7)	**$ 3.13**	$ 2.35	$ 3.18
Diluted earnings per share (Note 7)	**$ 3.11**	$ 2.34	$ 3.17

See notes to consolidated financial statements.

STATEMENT OF CONSOLIDATED RETAINED INCOME

year ended December 31 (in millions)	**2002**	2001	2000
Balance, January 1, as previously reported	**$ 1,441.7**	$ 1,239.4	$ 1,014.8
Adjustment for change in accounting policy (Note 3)	**–**	–	(97.5)
Balance, January 1, as restated	**1,441.7**	1,239.4	917.3
Net income for the year	**496.0**	372.5	502.6
Dividends			
Common Shares	**(80.8)**	(20.2)	–
Ordinary Shares	**–**	(150.0)	(180.5)
Balance, December 31	**$ 1,856.9**	$ 1,441.7	$ 1,239.4

See notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEET

year ended December 31 (in millions)	**2002**	2001
Assets		
Current assets		
Cash and short-term investments	**$ 284.9**	$ 556.9
Accounts receivable (Note 8)	**443.0**	464.1
Materials and supplies	**108.9**	102.3
Future income taxes (Note 6)	**72.5**	92.2
	909.3	1,215.5
Investments (Note 10)	**92.2**	94.9
Net properties (Note 11)	**8,149.3**	7,935.5
Other assets and deferred charges (Note 12)	**510.0**	415.2
Total assets	**$ 9,660.8**	$ 9,661.1
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	**$ 984.2**	$ 1,004.6
Income and other taxes payable	**92.6**	103.4
Dividends payable on Common Shares	**20.2**	20.2
Long-term debt maturing within one year (Note 13)	**400.8**	38.2
	1,497.8	1,166.4
Deferred liabilities (Note 15)	**654.4**	744.6
Long-term debt (Note 13)	**2,922.1**	3,709.0
Future income taxes (Note 6)	**1,200.1**	1,068.7
Shareholders' equity (Note 17)		
Share capital	**1,116.1**	1,114.1
Contributed surplus	**291.1**	291.1
Foreign currency translation adjustments	**122.3**	125.5
Retained income	**1,856.9**	1,441.7
	3,386.4	2,972.4
Total liabilities and shareholders' equity	**$ 9,660.8**	$ 9,661.1

Commitments and contingencies (Note 21).
See notes to consolidated financial statements.

Approved on behalf of the Board:

Tea Newall

J.E. Newall
Director

Roger Phillips

R. Phillips
Director

STATEMENT OF CONSOLIDATED CASH FLOWS

year ended December 31 (in millions)	**2002**	2001	2000
Operating activities			
Net income	**$ 496.0**	$ 372.5	$ 502.6
Add (deduct) items not affecting cash			
Depreciation and amortization	**348.4**	334.4	304.7
Future income taxes (Note 6)	**99.0**	130.8	111.3
Foreign exchange (gain) loss on long-term debt	**(13.4)**	58.2	32.1
Amortization of deferred charges (Note 4)	**19.3**	26.7	26.2
Other	**(0.8)**	(5.5)	(1.3)
	948.5	917.1	975.6
Restructuring payments	**(119.3)**	(132.4)	(163.1)
Other operating activities, net	**(45.0)**	(28.2)	(129.7)
Change in non-cash working capital balances related to operations (Note 9)	**–**	2.0	(6.2)
Cash provided by operating activities	**784.2**	758.5	676.6
Investing activities			
Additions to properties (Note 11)	**(558.5)**	(566.4)	(586.1)
Other investments	**4.0**	3.8	11.3
Net (costs) proceeds from disposal of transportation properties	**(17.2)**	(27.0)	37.9
Cash used in investing activities	**(571.7)**	(589.6)	(536.9)
Financing activities			
Dividends on Common Shares	**(80.8)**	–	–
Net dividends paid to Canadian Pacific Limited	**–**	(150.0)	(180.5)
Return of capital to Canadian Pacific Limited	**–**	(700.0)	–
Issuance of Common Shares	**2.0**	1.6	–
Issuance of long-term debt	**–**	2,395.6	599.8
Repayment of long-term debt	**(405.7)**	(1,221.2)	(0.9)
Equity contribution (to) from former affiliates (Note 17)	**–**	(8.3)	1.5
Advances to former affiliates	**–**	(50.0)	(479.3)
Cash (used in) provided by financing activities	**(484.5)**	267.7	(59.4)
Cash position			
(Decrease) increase in net cash	**(272.0)**	436.6	80.3
Net cash at beginning of year	**556.9**	120.3	40.0
Net cash at end of year	**$ 284.9**	$ 556.9	$ 120.3
Net cash is defined as:			
Cash and short-term investments	**$ 284.9**	$ 556.9	$ 120.3
	$ 284.9	$ 556.9	$ 120.3

See notes to consolidated financial statements.

1. REORGANIZATION

For the periods prior to October 1, 2001, Canadian Pacific Railway Company ("CPRC") was a wholly owned subsidiary of Canadian Pacific Limited ("CPL"). On October 1, 2001, as part of a corporate Plan of Arrangement, CPL distributed its interests in CPRC to a newly created, publicly held company, Canadian Pacific Railway Limited ("CPRL"). As a result, CPRC is now a wholly owned subsidiary of CPRL. As CPRL, CPRC and CPRC's subsidiaries (collectively referred to as "CPR", "the Company" or "Canadian Pacific Railway") were under the control of CPL, the transaction was accounted for in a manner similar to a pooling-of-interests and the historical financial information of CPRC became the historical financial information of newly formed CPRL.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation
These consolidated financial statements include the accounts of CPRL and all of its subsidiaries. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The Company's accounts have been adjusted to reflect an accounting basis that is more comparable with that employed by other Class I railways in North America. The unconsolidated books and records of the railway entities within the consolidated group continue to be reported according to generally accepted accounting practices for railways as prescribed in the regulations of the Canadian Transportation Agency in Canada and the Surface Transportation Board in the United States.

These consolidated financial statements are expressed in Canadian dollars, except where otherwise indicated. The preparation of these financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the period, the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements. On an ongoing basis, management reviews its estimates, including those related to environmental liabilities, pensions and other benefits, depreciable lives of properties, future income tax assets and liabilities as well as legal and personal injury liabilities based upon currently available information. Actual results could differ from these estimates.

Principal Subsidiaries
The following list sets out CPRL's principal railway operating subsidiaries, including the jurisdiction of incorporation and the percentage of voting securities owned directly or indirectly by CPRL as of the date hereof.

principal subsidiary	incorporated under the laws of	percentage of voting securities held directly or indirectly by the Company
Canadian Pacific Railway Company	Canada	100 %
Soo Line Railroad Company	Minnesota	100 %
Delaware and Hudson Railway Company, Inc.	Delaware	100 %

Revenue Recognition

Railway freight revenues are recognized based on the percentage of completed service method. Other revenue is recognized as service is performed or contractual obligations are met.

Cash and Short-term Investments

Cash and short-term investments include marketable investments that are readily convertible to cash and purchased three months or less from maturity. Short-term investments are stated at cost, which approximates market value.

Foreign Currency Translation

Foreign currency assets and liabilities of the Company's operations, other than through foreign subsidiaries, are translated into Canadian dollars at the year-end exchange rate for monetary items and at the historical exchange rates for non-monetary items. Foreign currency revenues and expenses are translated at the exchange rate in effect on the dates of the related transactions. All foreign currency gains and losses are included immediately in income.

The accounts of the Company's foreign subsidiaries are translated into Canadian dollars using the year-end exchange rate for assets and liabilities and the average exchange rates in effect for the year for revenues and expenses. Exchange gains and losses arising from translation of foreign subsidiaries' accounts are included under Shareholders' Equity as foreign currency translation adjustments. A portion of the U.S. dollar denominated long-term debt has been designated as a hedge of the net investment in self-sustaining foreign subsidiaries. Unrealized foreign exchange gains and losses on a portion of the U.S. dollar denominated long-term debt are offset against foreign exchange gains and losses arising from translation of self-sustaining foreign subsidiaries' accounts.

Pensions and Other Benefits

Pension costs are actuarially determined using the projected benefit method prorated over the credited service periods of employees. This method incorporates management's best estimate of expected plan investment performance, salary escalation and retirement ages of employees. Market-related values are used to calculate the expected return on plan assets. The discount rate used to determine the benefit obligation is based on market interest rates on high quality corporate debt instruments with matching cash flows. Unrecognized actuarial gains and losses in excess of 10 % of the greater of the benefit obligation and the market-related value of plan assets are amortized over the expected average remaining service period of active employees expected to receive benefits under the plan (approximately 12 years). The transitional asset and obligation arising from implementing the Canadian Institute of Chartered Accountants ("CICA") accounting standard Section 3461 "Employee Future Benefits" effective January 1, 2000, is being amortized over the expected average remaining service period of active employees who were expected to receive benefits under the plan at January 1, 2000 (approximately 13 years).

Benefits other than pensions, including health care, life insurance and workers' compensation, are actuarially determined and accrued on a basis similar to pension costs.

Materials and Supplies

Inventories of materials and supplies are valued at the lower of average cost and replacement value.

Properties

Fixed asset additions and major renewals are recorded at cost. The Company capitalizes computer system development costs on major new systems, including the related variable indirect costs. In addition, CPR capitalizes the cost of major overhauls and large refurbishments. When depreciable property is retired or otherwise disposed of in the normal course of business, the book value, less salvage, is charged to accumulated depreciation. The Company will review the carrying amounts of its properties whenever changes in circumstances indicate that such carrying amounts may not be recoverable based on future undiscounted cash flows or estimated net realizable value. When assets are deemed to be impaired, recorded asset values will be revised to the lower of the carrying amount or the net recoverable amount.

Depreciation is calculated on the straight-line basis at rates based on the estimated service life, taking into consideration the projected annual usage of depreciable property, except for rail and other track material in the United States, which is based directly on usage.

Equipment under capital lease is included in properties and depreciated over the period of expected use. Estimated service life used for principal categories of properties is as follows:

assets	years
Diesel locomotives	28 to 32
Freight cars	23 to 47
Ties	35 to 45
Rails – in first position	21 to 30
– in other than first position	54
Computer system development costs	5 to 15

Derivative Financial and Commodity Instruments

Derivative financial and commodity instruments may be used from time to time by the Company to manage its exposure to price risks relating to foreign currency exchange rates, interest rates and fuel prices. The Company's policy is to not utilize derivative financial and commodity instruments for trading or speculative purposes.

The Company enters from time to time into forward exchange contracts to hedge anticipated sales in U.S. dollars, the related accounts receivable as well as future capital acquisitions. Foreign exchange translation gains and losses on foreign currency denominated derivative financial instruments used to hedge anticipated U.S. dollar denominated sales are recognized as an adjustment of the revenues when the sale is recorded. Those used to hedge future capital acquisitions are recognized as an adjustment of the property amount when the acquisition is recorded.

The Company enters into interest rate swaps to manage the risk related to interest rate fluctuations. These swap agreements require the periodic exchange of payments without the exchange of the principal amount on which the payments are based. Interest expense on the debt is adjusted to include the payments owing or receivable under the interest rate swaps.

Unrealized gains and losses on derivative instruments used as hedges are recognized in income in the period that the hedged exposure is recognized in income, which is the same period the instrument is settled.

Restructuring Accrual and Environmental Remediation

Restructuring charges are recorded in the year detailed exit or restructuring plans are approved and communicated. Restructuring liabilities are recorded at their present value with the related discount being amortized over the payment period. Environmental remediation accruals cover 10 years of a site-specific remediation program. Provisions for labour restructuring and environmental remediation costs are recorded in deferred liabilities except for the current portion, which is recorded in accrued liabilities.

Income Taxes

The Company follows the liability method of accounting for income taxes. Future income tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities. These differences are then measured using substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect of a change in income tax rates on future income tax assets and liabilities is recognized in income in the period the change occurs.

Earnings per Share

Basic earnings per share are calculated using the weighted average number of common shares outstanding during the year. Diluted earnings per share are calculated using the treasury stock method for determining the dilutive effect of options.

Stock-based Compensation

No compensation expense is recognized when the exercise price equals the market price at the date when stock options are issued to employees under the Company's authorized stock-based compensation plans. Any consideration paid by employees on exercise of stock options or purchase of stock is credited to share capital. Compensation expense is recognized for stock appreciation rights ("SAR"), deferred share units ("DSU") and employee share purchase plans by amortizing the cost over the vesting period, with the liability for SARs and DSUs marked-to-market until exercised.

3. CHANGES IN ACCOUNTING POLICY

Foreign Currency Translation

Effective January 1, 2002, the Company adopted retroactively with restatement the CICA accounting standard for the treatment of foreign exchange gains and losses. The result of this restatement was to reduce opening retained income at January 1, 2000, by $97.5 million, decrease other assets and deferred charges at January 1, 2000, by $120.0 million and decrease future income taxes at January 1, 2000, by $22.5 million. The restatement also reduced net income by $29.7 million and $37.9 million and reduced basic and fully diluted earnings per share by 18 cents and 24 cents for the years ended December 31, 2000 and 2001, respectively.

Under the new standard, foreign exchange gains and losses on long-term debt can no longer be deferred and amortized to income. As a result, long-term debt of approximately CDN$2.3 billion denominated in U.S. dollars is translated into Canadian dollars using the period-end exchange rate, with the effect of the change from the previous period-end rate reflected in income. Approximately CDN$1.3 billion of the long-term debt is designated as a hedge of the net investment in self-sustaining U.S. subsidiaries.

Stock-based Compensation

Effective January 1, 2002, the Company adopted prospectively Section 3870 "Stock-based Compensation and Other Stock-based Payments." The effect on net income of adopting this standard was immaterial.

Hedging Transactions

In November 2001, the CICA issued Accounting Guideline 13 ("AcG 13") "Hedging Relationships," which will be effective for years beginning on or after July 1, 2003. AcG 13 addresses the identification, designation, documentation, and effectiveness of hedging transactions for the purposes of applying hedge accounting. It also establishes conditions for applying, and deals with the discontinuance of hedge accounting. In December 2002, the CICA approved, subject to written ballot, certain amendments to AcG 13. These amendments are expected to be finalized in the first half of 2003.

Under the new guideline, the Company will be required to document its hedging transactions and explicitly demonstrate the hedges are sufficiently effective in order to continue accrual accounting for positions hedged with derivatives. The effect on net income of adopting this guideline will be immaterial.

Special-purpose Entities

The Company expects to early adopt, retroactively without restatement the accounting rules described in the recent CICA draft guideline "Consolidation of Special-Purpose Entities" ("SPE") should the new rules be approved by the CICA. The draft guideline requires the primary beneficiary of an SPE to consolidate the SPE when the majority equity owner has not provided the SPE with sufficient funding through equity to allow it to finance its activities without relying on financial support from other parties with an interest in the SPE. CPR has one SPE of which it is the primary beneficiary and meets the criteria for consolidation. The impact of consolidating the SPE will be to increase net properties by approximately $208.0 million and long-term debt by approximately $209.0 million.

Guarantees

In December 2002, the CICA approved, subject to written ballot, the draft guideline relating to guarantees. The draft guideline requires disclosure of key information about certain types of guarantee contracts that require payments contingent on specified types of future events, and is effective for periods beginning on or after January 1, 2003. The Company expects to adopt this guideline in the first quarter of 2003.

Asset Retirement Obligations

In December 2002, the CICA approved, subject to written ballot, a new Handbook section "Asset Retirement Obligations" to replace the current guidance on future removal and site restoration costs included in the CICA accounting standard 3061 "Property, Plant and Equipment." The standard is effective for years beginning on or after January 1, 2004. The standard requires recognition of a liability at its fair value for the obligation associated with the retirement of a tangible long-lived asset. A corresponding asset retirement cost would be added to the carrying amount of the related asset and amortized to expense over the useful life of the asset. The effect of adopting this standard, on January 1, 2004, has not yet been determined.

4. OTHER CHARGES

(in millions)	**2002**	2001	2000
Amortization of discount on accruals recorded at present value	**$ 19.3**	$ 26.7	$ 29.4
Other exchange gains	**(1.6)**	(14.8)	(17.3)
Charges on sale of accounts receivable (Note 8)	**3.5**	5.7	7.1
Other	**0.6**	8.8	1.8
Total other charges	**$ 21.8**	$ 26.4	$ 21.0

Included in Other above are charges related to the early redemption of CPR's 8.85 % Debentures – specifically, a call premium of $17.5 million (see Note 13) and accelerated amortization of deferred financing charges of $2.5 million, which is offset by $27.0 million of interest income on an income tax settlement related to prior years (see Note 6).

5. INTEREST EXPENSE

(in millions)	**2002**	2001	2000
Interest expense	**$ 254.2**	$ 229.5	$ 178.2
Interest income	**(12.0)**	(19.9)	(11.2)
Total interest expense	**$ 242.2**	$ 209.6	$ 167.0
Cash interest payments	**$ 245.5**	$ 197.9	$ 168.3

No interest was paid to former affiliates during 2002 (2001 – $2.1 million; 2000 – $25.6 million).

6. INCOME TAXES

The following is a summary of the major components of the Company's income tax expense:

(in millions)	2002	2001	2000
Canada (domestic)			
Current income tax expense	$ 9.9	$ 10.3	$ 10.0
Future income tax expense			
Origination and reversal of temporary differences	149.5	139.6	222.1
Effect of change in tax rates	–	(64.0)	(131.7)
Previously unrecognized tax losses	(8.8)	–	–
Other	(81.0)	(4.6)	–
Total future income tax expense	59.7	71.0	90.4
Total income taxes (domestic)	$ 69.6	$ 81.3	$ 100.4
Other (foreign)			
Current income tax expense	$ 1.0	$ (8.5)	$ 1.2
Future income tax expense			
Origination and reversal of temporary differences	54.8	53.9	27.0
Effect of change in tax rates	–	–	0.9
Previously unrecognized tax losses	(15.5)	–	(7.0)
Other	–	5.9	–
Total future income tax expense	39.3	59.8	20.9
Total income taxes (foreign)	$ 40.3	$ 51.3	$ 22.1
Total			
Current income tax expense	$ 10.9	$ 1.8	$ 11.2
Future income tax expense	99.0	130.8	111.3
Total income taxes (domestic and foreign)	$ 109.9	$ 132.6	$ 122.5

The provision for future income taxes arises from temporary differences in the recognition of revenues and expenses for financial statement and income tax purposes. The temporary differences comprising the future income tax assets and liabilities are as follows:

(in millions)	2002	2001
Future income tax assets		
Restructuring liability	$ 145.6	$ 180.9
Amount related to tax losses carried forward	150.8	114.8
Liabilities carrying value in excess of tax basis	142.9	154.4
Future environmental remediation costs	18.7	24.9
Other	77.1	55.9
Total future income tax assets	535.1	530.9
Future income tax liabilities		
Capital assets carrying value in excess of tax basis	1,494.0	1,337.8
Prepaid expenses	118.0	93.1
Other	50.7	76.5
Total future income tax liabilities	1,662.7	1,507.4
Total net future income tax liability	1,127.6	976.5
Net current future income tax asset	72.5	92.2
Net long-term future income tax liability	$ 1,200.1	$ 1,068.7

The Company's consolidated effective income tax rate differs from the expected statutory tax rate. Expected income tax expense at statutory rates is reconciled to income tax expense as follows:

(in millions)	2002	2001	2000
Expected income tax expense at			
Canadian statutory tax rates	$ 227.3	$ 190.9	$ 281.3
Increase (decrease) in taxes resulting from:			
Large corporations tax	10.0	10.3	10.0
Gains not subject to tax	(19.4)	10.4	(7.3)
Foreign tax rate differentials	3.7	(10.4)	(26.7)
Effect of reduction in tax rates	–	(64.0)	(130.8)
Previously unrecognized tax losses	(24.3)	–	(7.0)
Other	(87.4)	(4.6)	3.0
Total income tax expense	$ 109.9	$ 132.6	$ 122.5

The Company has $74.0 million of unused non-capital tax losses for U.S. tax purposes expiring between 2004 and 2017, as well as $800.0 million of capital losses available indefinitely for Canadian tax purposes for which no future income tax asset has been recognized.

During 2002, as a result of a favourable decision by the Federal Court of Appeal (*the Queen v. Canadian Pacific Limited* (legally renamed Canadian Pacific Railway Company in 1996)), the Company reported a recovery of income taxes of approximately $72.0 million.

7. EARNINGS PER SHARE

At December 31, 2002, the number of shares outstanding was 158.5 million (2001 – 158.4 million).

Basic earnings per share have been calculated using net income for the year divided by the weighted average number of CPRL shares outstanding during the year. For the year ended December 31, 2001, the weighted average number of shares was calculated using the number of shares issued as a result of the corporate reorganization for the first nine months of 2001 (see Note 1) and the actual number of shares outstanding for the last three months of the year. For the year ended December 31, 2000, basic earnings per share have been calculated using the number of shares outstanding immediately after completion of the corporate reorganization.

Diluted earnings per share have been calculated using the treasury stock method, which gives effect to the dilutive value of outstanding options. At December 31, 2002, there were 0.7 million replacement options outstanding that had been exchanged after the spin-off for CPL stock options held by CPL employees. In 2002, 1.6 million stock options were issued to CPR employees (2001 – 2.7 million new options). For the year ended December 31, 2000, the dilutive effect of stock options was calculated based on the 0.9 million replacement options outstanding immediately after completion of the corporate reorganization.

The number of shares used in the earnings per share calculations is reconciled as follows:

(in millions)	**2002**	2001	2000
Weighted average shares outstanding	**158.5**	158.3	158.3
Dilutive effect of stock options	**0.8**	0.5	0.4
Weighted average diluted shares outstanding	**159.3**	158.8	158.7

(in dollars)	**2002**	2001	2000
Basic earnings per share	**$ 3.13**	$ 2.35	$ 3.18
Diluted earnings per share	**$ 3.11**	$ 2.34	$ 3.17

8. SALE OF ACCOUNTS RECEIVABLE

The Company has a securitization agreement involving the non-recourse sale of accounts receivable on a revolving basis, which at December 31, 2002, amounted to $132.0 million (2001 – $132.0 million). Cash proceeds on these receivables were $120.0 million (2001 – $120.0 million) with $12.0 million (2001 – $12.0 million) having been held back as a reserve to be released to the Company upon termination of the agreement. Discounts on the revolving sales and program fees of $3.5 million in 2002 (2001 – $5.7 million; 2000 – $7.1 million) were included in the income statement as part of Other Charges (see Note 4). The reserve is valued on the Company's books at an amount equal to the undiscounted expected future cash flows. The Company acts as the collector of the receivable but has no claim against the proceeds of collection of the securitized receivables.

9. CHANGE IN NON-CASH WORKING CAPITAL BALANCES RELATED TO OPERATIONS

(in millions)	2002	2001	2000
Source (use) of cash:			
Accounts receivable	**$ 21.1**	$ 31.2	$ 8.5
Materials and supplies	**(6.6)**	28.7	45.1
Accounts payable and accrued liabilities	**(20.4)**	3.1	(116.5)
Income and other taxes payable	**(10.8)**	(54.7)	47.1
Change in non-cash working capital	**(16.7)**	8.3	(15.8)
Exclude amounts reported elsewhere on the statement of consolidated cash flows:			
(Increase) decrease in current portion of restructuring provisions included in accounts payable and accrued liabilities	**(4.4)**	(2.4)	53.5
Decrease in accounts payable and accrued liabilities resulting from additions to properties	**7.4**	3.7	14.9
Other	**–**	–	(18.7)
Other changes in non-cash working capital balances (reclassification to (from) long-term liabilities from (to) current liabilities)	**13.7**	(7.6)	(40.1)
Change in non-cash working capital balances related to operations	**$ –**	$ 2.0	$ (6.2)

10. INVESTMENTS

(in millions)	2002	2001
Rail investments accounted for on an equity basis	**$ 61.2**	$ 50.9
Other investments accounted for on a cost basis	**31.0**	44.0
Total investments	**$ 92.2**	$ 94.9

11. NET PROPERTIES

(in millions)	cost	accumulated depreciation	net book value
2002			
Track and roadway	**$ 7,315.2**	**$ 2,245.6**	**$ 5,069.6**
Buildings	**348.1**	**123.8**	**224.3**
Rolling stock	**3,067.7**	**1,277.5**	**1,790.2**
Other	**1,590.0**	**524.8**	**1,065.2**
Total net properties	**$ 12,321.0**	**$ 4,171.7**	**$ 8,149.3**
2001			
Track and roadway	$ 7,005.5	$ 2,179.7	$ 4,825.8
Buildings	340.3	120.8	219.5
Rolling stock	3,100.2	1,264.0	1,836.2
Other	1,554.7	500.7	1,054.0
Total net properties	$ 12,000.7	$ 4,065.2	$ 7,935.5

At December 31, 2002, net properties included assets held under capital lease of $399.3 million at cost (2001 – $399.8 million), and related accumulated depreciation of $57.8 million (2001 – $44.2 million).

During the year, capital assets were acquired under the Company's capital program at an aggregate cost of $551.1 million (2001 – $688.3 million), none of which were acquired by means of capital leases (2001 – $133.0 million). During 2001, operating leases on certain rolling stock were converted to capital leases, increasing properties by $64.8 million. Cash payments related to capital purchases were $558.5 million in 2002 (2001 – $566.4 million), including payments for capital purchases contained in accounts payable in prior years. At December 31, 2002, no amounts (2001 – $7.4 million) remained in accounts payable related to the above purchases.

12. OTHER ASSETS AND DEFERRED CHARGES

(in millions)	**2002**	2001
Prepaid pension costs	**$ 335.6**	$ 270.2
Other	**174.4**	145.0
Total other assets and deferred charges	**$ 510.0**	$ 415.2

(in millions)	currency in which payable	**2002**	2001
6.250 % Notes due 2011	US$	**$ 631.0**	$ 636.0
7.125 % Debentures due 2031	US$	**552.2**	556.5
6.875 % Debentures due 2003	US$	**394.4**	397.5
9.450 % Debentures due 2021	US$	**394.4**	397.5
8.850 % Debentures due 2022	US$	**–**	397.5
7.20 % Medium Term Notes due 2005	CDN$	**250.0**	250.0
6.91 % Secured Equipment Notes due 2005 – 2024	CDN$	**235.0**	235.0
7.49 % Equipment Trust Certificates due 2005 – 2021	US$	**189.3**	190.8
Secured Equipment Loan due 2003 – 2015	CDN$	**160.6**	162.8
Obligations under capital leases due 2003 – 2022 (6.85 % – 7.65 %)	US$	**448.4**	456.4
Obligations under capital leases due 2006 (7.88 % – 10.93 %)	CDN$	**1.8**	2.1
Other	US$	**1.0**	1.2
		3,258.1	3,683.3
Perpetual 4 % Consolidated Debenture Stock	US$	**50.5**	50.9
Perpetual 4 % Consolidated Debenture Stock	GBP£	**14.3**	13.0
		3,322.9	3,747.2
Less: Long-term debt maturing within one year		**400.8**	38.2
		$ 2,922.1	$ 3,709.0

At December 31, 2002, long-term debt denominated in U.S. dollars was CDN$2,661.2 million (2001 – CDN$3,084.3 million).

Interest on each of the following instruments is paid semi-annually. Interest on the 6.250 % Notes and the 7.125 % and 6.875 % Debentures is paid on April 15 and October 15 of each year, with final interest payment and principal repayment for the 6.875 % Debentures occurring on April 15, 2003. Interest on the 9.450 % Debentures is paid on February 1 and August 1 of each year. All of these notes and debentures are unsecured, but carry a negative pledge.

The 8.850 % Debentures were called in June 2002. As a result of the early redemption, CPR was required to pay a call premium of $17.5 million and accelerate the amortization of the related remaining deferred financing charges of $2.5 million. Both these items are included in Other Charges (see Note 4).

The Medium Term Notes are unsecured but carry a negative pledge. Interest is paid semi-annually in arrears on June 28 and December 28 of each year.

The Secured Equipment Notes are full recourse obligations of the Company secured by a first charge on specific units of railway rolling stock. The Company is making semi-annual payments of interest in the amount of $8.1 million on April 1 and October 1 of each year, up to and including October 1, 2004. Thereafter, the Company will pay on April 1 and October 1 of each year, commencing April 1, 2005, up to and including October 1, 2024, equal blended semi-annual payments of principal and interest of $10.9 million.

The Equipment Trust Certificates are secured by specific locomotive units. Semi-annual interest payments of US$4.5 million are being made on January 15 and July 15 of each year, up to and including January 15, 2005. Thereafter, semi-annual payments will vary in amount and will be interest-only payments or blended principal and interest payments. Final payment of principal is due January 15, 2021.

The Secured Equipment Loan is secured by specific locomotive units. The interest rate is floating and is calculated based on a six-month average CDOR (calculated based on an average of Bankers' Acceptance rates) plus 53 basis points (2002 – 3.13 %; 2001 – 4.67 %; and 2000 – 6.54 %). The Company makes blended payments of interest and principal semi-annually on February 1 and August 1 of each year.

The Consolidated Debenture Stock, created by an Act of Parliament of 1889, constitutes a first charge upon and over the whole of the undertaking, railways, works, rolling stock, plant, property and effects of the Company, with certain exceptions.

Annual maturities and sinking fund requirements, excluding those pertaining to capital leases, for each of the five years following 2002 are (in millions): 2003 – $396.8; 2004 – $2.5; 2005 – $260.8; 2006 – $14.7; 2007 – $15.1.

At December 31, 2002, capital lease obligations included in long-term debt were as follows:

(in millions)	year	capital leases
Minimum lease payments in:		
	2003	$ 36.0
	2004	37.1
	2005	37.1
	2006	38.9
	2007	40.4
	Thereafter	664.6
Total minimum lease payments		854.1
Less: Imputed interest		403.9
Present value of minimum lease payments		450.2
Less: Current portion		4.0
Long-term portion of capital lease obligations		$ 446.2

14. FINANCIAL INSTRUMENTS

Forward Foreign Currency Exchange Contracts

Exposure to changes arising from fluctuations in exchange rates between Canadian and U.S. dollars on future revenue streams and certain U.S. dollar expenditures has been managed by selling or purchasing forward U.S. dollars at fixed rates in future periods, which are accounted for as cash flow hedges. At December 31, 2002, the Company had entered into foreign exchange contracts to purchase approximately US$40.0 million (2001 – contracts to sell approximately US$170.0 million) in January 2003 at an effective exchange rate of 1.56 (2001 – 1.45 to 1.47). At December 31, 2002, the unrealized gain on forward foreign currency exchange contracts was CDN$0.9 million (unrealized loss in 2001 – CDN$25.0 million).

Commodity Contracts

Exposure to fluctuations in fuel prices has been managed by selling or purchasing crude oil futures. At December 31, 2002, the Company had entered into futures contracts, which are accounted for as cash flow hedges, to purchase approximately 5,116,000 barrels (2001 – 5,755,000) over the years 2003 to 2007 at average annual prices ranging from US$22.20 to US$20.83 per barrel (2001 – US$23.79 to US$20.68). At December 31, 2002, the unrealized gain on crude oil futures was CDN$26.3 million (unrealized loss in 2001 – CDN$19.4 million).

Interest Rate Contracts

At December 31, 2002, the Company had an outstanding interest rate swap agreement, accounted for as a fair value hedge, for a nominal amount of CDN$40.8 million (2001 – CDN$40.8 million) which converts a portion of its fixed interest rate liability into a variable rate liability.

The following table discloses the terms of the swap agreement in place at December 31, 2002:

expiration	November 2003
Notional amount of principal (in millions)	$ 40.8
Fixed receiving rate	8.0 %
Variable paying rate [1]	5.1 %

[1] Based on Bankers' Acceptances.

The Company is also party to agreements that have established the borrowing rate on CDN$200 million of long-term debt, expected to be issued within the first four months of 2003. Unrealized losses on this arrangement, which is accounted for as a cash flow hedge, are currently $13.6 million and are expected to be amortized over the life of the issue.

Credit Risk Management

The Company is exposed to credit losses in the event of non-performance by counterparties to financial instruments. However, the Company does not anticipate such non-performance as dealings have been with counterparties of high credit quality. In addition, the Company believes there are no significant concentrations of credit risk.

Interest Rate Exposure and Fair Values

The Company's exposure to interest rate risk along with the total carrying amounts and fair values of its financial instruments is summarized in the following table:

(in millions)	at floating interest rates	fixed interest rate maturing in 2003	2004 to 2007	2008 and after	total carrying value	fair value
Financial assets						
Cash and short-term investments 2002	$ 284.9	$ –	$ –	$ –	$ 284.9	$ 284.9
Cash and short-term investments 2001	$ 556.9	$ –	$ –	$ –	$ 556.9	$ 556.9
Financial liabilities						
6.250 % Notes	–	–	–	631.0	631.0	701.0
7.125 % Debentures	–	–	–	552.2	552.2	644.0
6.875 % Debentures	–	394.4	–	–	394.4	399.4
9.450 % Debentures	–	–	–	394.4	394.4	551.8
Medium Term Notes	–	–	250.0	–	250.0	267.3
Secured Equipment Notes	–	–	18.3	216.7	235.0	251.1
Equipment Trust Certificates	–	–	10.8	178.5	189.3	230.2
Secured Equipment Loan	160.6	–	–	–	160.6	160.6
4 % Consolidated Debenture Stock	–	–	–	64.8	64.8	54.6
Obligations under capital leases	–	4.0	30.3	415.9	450.2	512.0
Other	–	0.2	0.8	–	1.0	1.0
Forward foreign currency contracts	–	–	–	–	–	0.9
Crude oil futures	–	–	–	–	–	26.3
Interest rate swaps	40.8	(40.8)	–	–	–	1.0
Interest rate locks	–	–	–	–	–	(13.6)
Total financial liabilities 2002					$ 3,322.9	$ 3,787.6
Total financial liabilities 2001					$ 3,747.2	$ 3,851.7

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies. However, considerable judgment is necessary to develop these estimates. Accordingly, the estimates presented herein are not necessarily indicative of what the Company could realize in a current market exchange. The use of different assumptions or methodologies may have a material effect on the estimated fair value amounts.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

- Short-term financial assets and liabilities are valued at their carrying amounts as presented in the balance sheet, which are reasonable estimates of fair value due to the relatively short period to maturity of these instruments.
- The fair value of publicly traded long-term debt is determined based on market prices at December 31, 2002. The fair value of other long-term debt is estimated based on rates currently available to the Company for long-term borrowings with terms and conditions similar to those borrowings in place at the balance sheet date.

- The fair value of derivative instruments is estimated as the unrealized gain or loss calculated based on market prices or rates at December 31, 2002, which generally reflects the estimated amounts the Company would receive or pay to terminate the contracts at the balance sheet date.

15. DEFERRED LIABILITIES

(in millions)	2002	2001
Provision for restructuring and environmental remediation (Note 16)	$ 441.8	$ 551.0
Deferred workers' compensation	179.1	143.6
Accrued employee benefits	115.8	100.3
Fibre optics rights-of-way deferred revenue	61.0	58.0
Other	75.9	77.4
	873.6	930.3
Less: Amount payable/realizable within one year	219.2	185.7
Total deferred liabilities	$ 654.4	$ 744.6

Fibre optics rights-of-way deferred revenue is being amortized to income on a straight-line basis over the related lease terms.

16. RESTRUCTURING ACCRUAL AND ENVIRONMENTAL REMEDIATION

At December 31, 2002, the provision for restructuring and environmental remediation was $441.8 million (2001 – $551.0 million). This provision is primarily comprised of labour liabilities for restructuring plans that are substantially implemented as well as the liability for a multi-year soil remediation program. Labour liabilities reflect the expected residual payments to protected employees.

During 2002, CPR began new restructuring initiatives to reduce costs by eliminating 85 positions. The reductions occurred mostly in administrative areas. These initiatives required an increase to the provision of $6.8 million. This change was offset by a net reduction of $3.9 million of previously accrued initiatives due to net experience gains and by an additional $2.3 million present value discount due to a delay in expected payments.

During 2001, CPR announced an additional restructuring initiative to reduce costs by eliminating 500 positions in the area of administration as well as in operations, particularly fleet maintenance. The new initiative required an increase to the provision of $59.5 million (2000 – $18.2 million). This change was offset by a net reduction of $72.7 million (2000 – $24.1 million) of previously accrued initiatives. The reductions resulted from a decrease in the number of surplus crews due to a projected increase in traffic volumes, modifications in the regulatory environment, cost reductions from rule modifications in the latest collective agreements and experience gains.

Reorganization

During 2001, as part of a corporate reorganization, CPL distributed its interest in CPRC to a newly created publicly held company, CPRL. CPRL Common Shares were issued at a ratio of 1:2 for each CPL share outstanding. The number of CPRL shares outstanding on October 5, 2001, being the date that former shareholders of CPL became shareholders of CPRL, was 158.3 million. The CPRC Ordinary Shares outstanding at the time of reorganization are now wholly owned by CPRL.

Authorized and Issued Share Capital

The Company's Articles of Incorporation authorize for issuance an unlimited number of Common Shares and an unlimited number of First Preferred Shares and Second Preferred Shares. At December 31, 2002, no Preferred Shares had been issued.

An analysis of Ordinary and Common Share balances is as follows:

(in millions)	number	amount
2002		
Balance, January 1	**158.4**	**$ 1,114.1**
Common Shares issued under stock option plans	**0.1**	**2.0**
Balance, December 31	**158.5**	**$ 1,116.1**
2001		
Balance, October 5	347.2	$ 1,812.5
Return of capital to CPL on reorganization	–	(700.0)
Ordinary Shares exchanged on reorganization	(347.2)	(1,112.5)
Common Shares issued as part of share exchange on reorganization	158.3	1,112.5
Common Shares issued under stock option plans	0.1	1.6
Balance, December 31	158.4	$ 1,114.1

Contributed Surplus

During 2001, the Company paid net capital contributions totalling $8.3 million to former affiliates.

Foreign Currency Translation Adjustments

Included in equity are the following cumulative foreign currency translation adjustments:

(in millions)	**2002**	2001
Balance, January 1	**$ 125.5**	$ 84.3
Change in foreign currency translation rates on foreign subsidiaries	**(8.3)**	44.1
Other	**(3.2)**	(2.9)
Balance, December 31, before designated hedge	**$ 114.0**	$ 125.5
Designated hedge	**8.3**	–
Balance December 31, including designated hedge	**$ 122.3**	$ 125.5

Pensions and Other Benefits, Excluding Post-employment Restructuring Benefits

The Company has both defined benefit ("DB") and defined contribution ("DC") pension plans.

The DB plans provide for pensions based principally on years of service and compensation rates near retirement. Annual contributions to the DB plans, which are actuarially determined, are made on the basis of not less than the minimum amounts required by federal or provincial pension supervisory authorities.

Other benefits include post-retirement medical and life insurance for pensioners, and post-employment workers' compensation benefits, which are based on Company-specific claims.

At December 31, the net benefit (credit) expense for DB pension plans and other benefits included the following components:

	pensions		other benefits	
(in millions)	**2002**	2001	**2002**	2001
Current service cost (benefits earned by employees in the year)	**$ 61.7**	$ 60.5	**$ 14.6**	$ 16.5
Interest cost on benefit obligation	**387.1**	374.3	**25.6**	23.7
Expected return on pension fund assets	**(450.0)**	(444.2)	**–**	–
Amortization of:				
Transitional (asset) obligation	**(15.6)**	(15.6)	**13.4**	13.8
Prior year service cost	**11.8**	8.6	**–**	–
Net actuarial loss (gain)	**0.3**	(0.2)	**0.8**	–
Net benefit (credit) expense	**$ (4.7)**	$ (16.6)	**$ 54.4**	$ 54.0

Information about the Company's DB pension plans and other benefits, in aggregate, is as follows:

	pensions		other benefits	
(in millions)	**2002**	2001	**2002**	2001
Change in benefit obligation:				
Benefit obligation at January 1	**$ 5,844.5**	$ 5,604.0	**$ 379.2**	$ 340.5
Transferred to DC plan	**–**	(31.6)	**–**	–
Current service cost	**61.7**	60.5	**14.6**	16.5
Interest cost	**387.1**	374.3	**25.6**	23.7
Employee contributions	**46.4**	49.0	**–**	–
Benefits paid	**(364.8)**	(350.2)	**(32.9)**	(28.4)
Foreign currency changes	**(1.1)**	7.8	**(0.4)**	2.7
Plan amendments	**(4.5)**	88.6	**(5.1)**	–
Actuarial loss	**23.8**	42.1	**42.8**	24.2
Benefit obligation at December 31	**$ 5,993.1**	$ 5,844.5	**$ 423.8**	$ 379.2
Change in fund assets:				
Fair value of fund assets at January 1	**$ 5,484.7**	$ 5,711.3	**$ –**	$ 11.7
Transferred to DC plan	**–**	(31.6)	**–**	–
Actual return on fund assets	**(95.6)**	57.7	**–**	–
Employer contributions	**59.9**	42.3	**32.9**	16.7
Employee contributions	**46.4**	49.0	**–**	–
Benefits paid	**(364.8)**	(350.2)	**(32.9)**	(28.4)
Foreign currency changes	**(1.0)**	6.2	**–**	–
Fair value of fund assets at December 31	**$ 5,129.6**	$ 5,484.7	**$ –**	$ –
Funded status – plan deficit	**$ (863.5)**	$ (359.8)	**$ (423.8)**	$ (379.2)
Unamortized prior service cost	**107.8**	122.8	**–**	–
Unamortized net transitional (asset) obligation	**(160.7)**	(176.4)	**133.1**	151.6
Unamortized experience losses:				
Deferred investment losses due to use of market-related value to determine pension expense	**600.8**	255.0	**–**	–
Unamortized net actuarial loss [(1)]	**641.8**	420.0	**74.4**	32.8
Accrued benefit asset (liability) in the consolidated balance sheet	**$ 326.2**	$ 261.6	**$ (216.3)**	$ (194.8)

[(1)] The amount by which these losses exceed the 10 % corridor (representing 10 % of the benefit obligation) is equal to $42.5 million at December 31, 2002 (2001 – nil). This amount will be amortized over the expected average remaining service period of active employees expected to receive benefits under the plan (approximately 12 years) starting in 2003.

At December 31, 2002, fund assets consisted primarily of listed stocks and bonds, including 760,000 CPRL Common Shares (2001 – 775,000) at a market value of $23.7 million (2001 – $24.9 million).

Included in the benefit obligation and fair value of fund assets at year end were the following amounts in respect of plans where the benefit obligation exceeds the fund assets:

	pensions		other benefits	
(in millions)	**2002**	2001	**2002**	2001
Benefit obligation	**$(5,993.1)**	$ (5,844.5)	**$ (423.8)**	$ (379.2)
Fair value of fund assets	**5,129.6**	5,484.7	**–**	–
	$ (863.5)	$ (359.8)	**$ (423.8)**	$ (379.2)

Actuarial assumptions used at December 31 are approximately:

(percentage)	**2002**	2001
Discount rate for plan obligation	**6.75**	6.75
Projected future salary increases	**3.00**	3.00
Expected rate of return on fund assets for the year ended December 31	**8.00**	8.00
Health care cost trend rate [1]	**6.90**	7.50

[1] The health care cost trend rate is projected to decrease by 0.6 % per year to approximately 4.5 % per year.

Effective January 1, 2001, the Company offered Canadian non-unionized employees the option to convert to a DC plan. The DC plan provides a pension based on total employee and employer contributions plus investment income earned on those contributions. Employee contributions are based on a percentage of salary. The Company matches employee contributions to a maximum percentage each year. In 2002, the net expense of this plan, which generally equals the employer's required contribution, was $2.6 million (2001 – $2.6 million).

Post-employment Restructuring Benefits

The Company accrues post-employment labour liabilities as part of its restructuring accruals (see Note 16). The labour portion of the Company's accrued restructuring liability was as follows:

(in millions)	**2002**	2001
Change in liability:		
Restructuring labour liability at January 1	**$ 306.4**	$ 389.1
Plan adjustment	**(1.1)**	(12.8)
Settlement gain	**–**	(4.4)
Interest cost	**18.1**	21.7
Benefits paid	**(83.3)**	(90.0)
Foreign currency changes	**(0.4)**	2.8
Restructuring labour liability at December 31	**239.7**	306.4
Unfunded restructuring labour asset	**(239.7)**	(306.4)
Unamortized net transitional asset	**(73.3)**	(90.9)
Accrued restructuring labour liability in the consolidated balance sheet	**$ (313.0)**	$ (397.3)

At December 31, 2002, the Company had several stock-based compensation plans, including a stock option plan, tandem SARs, a DSU plan, and an employee stock savings plan. These plans resulted in a compensation cost in the year of $7.4 million (2001 – $4.7 million).

In 2001, charges of $16.6 million for stock compensation resulting from increases in share values between the date the spin-off was announced on February 12, 2001, and the date the spin-off was completed on October 1, 2001, were included in the income statement as part of Spin-off Related, Incentive Compensation and Unusual Charges.

Replacement Options and SARs

Due to the reorganization of CPL, all CPL employees who held CPL options at the date of the spin-off received in exchange for their CPL options fully vested replacement options and SARs in the spun-off companies, according to the reorganization ratio used for Common Shares. The exercise price of the CPL options and SARs was allocated among the replacement options and SARs of each of the spun-off companies based on a formula using the weighted average trading price of the spun-off companies for their first 10 days of trading.

By agreement between CPRL and its former affiliates, the difference between the strike price and the exercise price of SARs of the former affiliates held by CPRL employees is recognized as an expense by CPRL. The difference between the strike price and the exercise price of CPRL SARs held by employees of the former affiliates is recovered from the former affiliates.

SARs are attached to 50 % of the options and there is a one-to-one cancellation ratio between those options and SARs.

Stock Option Plans and SARs

Under the Company's stock option plans, options are granted to eligible employees and all Directors to purchase Common Shares of the Company at a price equal to the market value of the shares at the grant date. Consequently, these options do not result in a charge to net income. Pursuant to the employee plan, regular options may be exercised upon vesting, which is between 24 and 36 months after the grant date. Performance options vest after 48 months unless certain performance targets are achieved, in which case vesting is accelerated.

At December 31, 2002, there were 6,373,659 (2001 – 7,778,930) Common Shares available for the granting of future options under the stock option plans out of the 11,500,000 Common Shares currently authorized.

With the grant of an option, employees may be simultaneously granted SARs equivalent to one-half the number of regular options granted. A SAR entitles the holder to receive payment of an amount equal to the excess of the market value of a Common Share at the exercise date of the SAR over the related option exercise price. On an ongoing basis, a liability for SARs is accrued on the incremental change in the market value of the underlying stock and amortized to income over the vesting period. SARs may be exercised no earlier than two years and no later than 10 years after the grant date.

Where an option granted is a tandem award, the holder can choose to exercise an option or a SAR of equal intrinsic value.

No options expired during 2002. The following is a summary of the Company's fixed stock option plan as of December 31:

2002	number of options	weighted average exercise price
Outstanding, January 1	**3,607,622**	**$ 23.99**
Replacement options granted	**–**	**–**
New options granted	**1,550,725**	**30.65**
Exercised	**(139,101)**	**13.50**
Forfeited	**(145,455)**	**22.19**
Outstanding, December 31	**4,873,791**	**$ 26.61**
Options exercisable at December 31	**827,426**	**$ 16.31**

2001	number of options	weighted average exercise price
Outstanding, January 1	–	$ –
Replacement options granted	1,159,036	13.99
New options granted	2,699,700	27.62
Exercised	(113,448)	14.34
Forfeited	(137,666)	13.82
Outstanding, December 31	3,607,622	$ 23.99
Options exercisable at December 31	907,922	$ 13.97

At December 31, 2002, the details of the stock options outstanding were as follows:

	options outstanding			options exercisable	
range of exercise prices	number of options	weighted average years to expiration	weighted average exercise price	number of options	weighted average exercise price
$ 9.30 – $ 9.83	53,338	1	$ 9.81	53,338	$ 9.81
$10.49 – $14.61	481,315	6	$ 13.61	481,315	$ 13.51
$15.61 – $18.96	172,773	5	$ 16.85	172,773	$ 16.85
$27.62 – $35.15	4,166,365	9	$ 28.74	120,000	$ 29.61
Total	4,873,791	8	$ 26.61	827,426	$ 16.31

Deferred Share Unit Plan

The Company established the DSU plan as a means to compensate and assist in attaining share ownership targets set for certain key employees and Directors. A DSU entitles the holder to receive, upon redemption, a cash payment equivalent to the market value of a Common Share at the redemption date. DSUs vest over various periods of up to 36 months and are only redeemable for a specified period after employment is terminated.

Key employees may choose to receive DSUs in lieu of cash payments for certain incentive programs. In addition, when acquiring Common Shares to meet share ownership targets, key employees may be granted a matching number of DSUs up to 33 % of the shares and DSUs acquired during the first six months after becoming eligible under the plan and, thereafter, up to 25 %. Key employees have five years to meet their ownership targets.

An expense to income for DSUs is recognized over the vesting period for both the initial subscription price and the change in value between reporting periods. At December 31, 2002, there were 214,911 (2001 – 28,669) DSUs outstanding. No DSUs were redeemed in 2002.

Employee Share Purchase Plan

In October 2001, the Company created an employee share purchase plan whereby both employee and Company contributions are used to purchase shares on the open market for the employee. The Company's contributions are expensed over the one-year vesting period.

For those employees who enrolled in the plan prior to December 31, 2001, the Company contributes $1,000 (US$650) for the first $1,000 contributed by the employee. After a threshold of $1,000 is reached, and for employees who join the plan subsequent to December 31, 2001, the Company matches $1 for every $3 contributed by the employee.

All employees have the opportunity to participate in the program to a maximum of 6 % of annual salary.

At December 31, 2002, there were 9,746 (2001 – 10,087) participants in the plan. The total number of shares purchased in 2002 on behalf of participants, including the Company contribution, was 1,023,624 (2001 – 185,661) shares. In 2002, the Company's contributions totalled $11.3 million (2001 – $4.2 million).

Additional Fair Value Disclosure

The issuance or exercise of the stock options authorized by CPR's stock compensation plan does not result in a charge to income when the exercise price equals the market price of the stock on the grant date, while an expense for SARs is recognized over the vesting period on the incremental change in the market value of the underlying stock between reporting periods. Had CPR used the fair value method, the fair value of options granted on or after January 1, 2002, would have been amortized to compensation expense over the vesting period of the options. Under the fair value method, CPR's pro forma basis net income and earnings per share would have been as follows:

		2002
Net income (in millions)	As reported	$ 496.0
	Pro forma	$ 492.9
Basic earnings per share (in dollars)	As reported	$ 3.13
	Pro forma	$ 3.11
Diluted earnings per share (in dollars)	As reported	$ 3.11
	Pro forma	$ 3.09

Under the fair value method, the pro forma fair value of options at the grant date calculated using the Black-Scholes option-pricing model is estimated to be $8.4 million. The weighted average assumptions were approximately:

	2002
Expected option life (years)	4.41
Risk-free interest rate	4.45 %
Expected stock price volatility	30 %
Expected annual dividends per share	$ 0.51

20. RELATED PARTY TRANSACTIONS

No rail services were provided to related parties in 2002. For the first nine months of 2001, leading up to the date of the spin-off, $328.2 million of rail services were provided to former affiliates (for the 12 months ended December 31, 2000 – $417.7 million). No amounts were included in accounts receivable at December 31, 2002 (2001 – $23.1 million) as a result of these transactions.

21. COMMITMENTS AND CONTINGENCIES

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to injuries and damage to property. The Company maintains provisions it considers to be adequate for such actions. While the final outcome with respect to actions outstanding or pending at December 31, 2002, cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company's financial position or results of operations.

At December 31, 2002, the Company had committed to future capital expenditures amounting to $197.2 million.

At December 31, 2002, the Company had a committed unused line of credit of $666.0 million available for short-term and long-term financing, repayable three years after signing and prepayable at the Company's option. The interest rate varies based on bank prime, Bankers' Acceptances or the London InterBank Offered Rate.

Minimum payments under operating leases were estimated at $486.0 million in aggregate, with annual payments in each of the five years following 2002 of (in millions): 2003 – $131.6; 2004 – $104.0; 2005 – $93.0; 2006 – $71.5; 2007 – $48.6.

Operating Segment

The Company operates in only one operating segment: rail transportation. The financial information presented at this level is used by management for decision making.

No customer accounts for more than 10 % of the Company's revenue.

Geographic Information

(in millions)	Canada	United States	total
2002			
Revenues	**$ 2,607.5**	**$ 1,058.1**	**$ 3,665.6**
Net properties	**$ 6,189.6**	**$ 1,959.7**	**$ 8,149.3**
2001			
Revenues	$ 2,665.6	$ 1,033.0	$ 3,698.6
Net properties	$ 5,992.6	$ 1,942.9	$ 7,935.5
2000			
Revenues	$ 2,697.1	$ 958.0	$ 3,655.1
Net properties	$ 5,620.4	$ 1,768.9	$ 7,389.3

Consolidating Information – 2002

(in millions)	Canada	United States	other countries	consolidating entries	total
Revenues	$ 2,607.5	$ 1,058.1	$ –	$ –	$ 3,665.6
Operating expenses	2,078.8	887.5	–	(157.2)	2,809.1
Operating income	528.7	170.6	–	157.2	856.5
Interest and other charges	240.7	29.8	(6.5)	–	264.0
Foreign exchange (gain) loss on long-term debt	(15.5)	–	2.1	–	(13.4)
Income taxes	18.3	42.3	0.2	49.1	109.9
Net income	$ 285.2	$ 98.5	$ 4.2	$ 108.1	$ 496.0
Current assets	$ 663.1	$ 310.2	$ 2.0	$ (66.0)	$ 909.3
Net properties	4,991.8	1,959.7	–	1,197.8	8,149.3
Other long-term assets	520.0	82.1	0.1	–	602.2
Total assets	$ 6,174.9	$ 2,352.0	$ 2.1	$ 1,131.8	$ 9,660.8
Current liabilities	$ 1,242.0	$ 325.1	$ (0.6)	$ (68.7)	$ 1,497.8
Long-term liabilities	3,835.0	734.3	(1.3)	208.6	4,776.6
Shareholders' equity	1,097.9	1,292.6	4.0	991.9	3,386.4
Total liabilities and shareholders' equity	$ 6,174.9	$ 2,352.0	$ 2.1	$ 1,131.8	$ 9,660.8

Consolidating Information – 2001

(in millions)	Canada	United States	other countries	consolidating entries	total
Revenues	$ 2,665.1	$ 1,033.0	$ –	$ 0.5	$ 3,698.6
Operating expenses	2,191.2	870.5	–	(179.6)	2,882.1
Operating income	473.9	162.5	–	180.1	816.5
Interest and other charges	248.3	38.5	(33.6)	–	253.2
Foreign exchange loss on long-term debt	58.2	–	–	–	58.2
Income taxes	58.0	50.8	0.5	23.3	132.6
Net income	$ 109.4	$ 73.2	$ 33.1	$ 156.8	$ 372.5
Current assets	$ 956.1	$ 310.6	$ 3.1	$ (54.3)	$ 1,215.5
Net properties	4,958.3	1,942.9	–	1,034.3	7,935.5
Other long-term assets	486.2	23.9	–	–	510.1
Total assets	$ 6,400.6	$ 2,277.4	$ 3.1	$ 980.0	$ 9,661.1
Current liabilities	$ 930.4	$ 292.8	$ 0.1	$ (56.9)	$ 1,166.4
Long-term liabilities	4,634.3	735.5	(0.5)	153.0	5,522.3
Shareholders' equity	835.9	1,249.1	3.5	883.9	2,972.4
Total liabilities and shareholders' equity	$ 6,400.6	$ 2,277.4	$ 3.1	$ 980.0	$ 9,661.1

Consolidating Information – 2000

(in millions)	Canada	United States	other countries	consolidating entries	total
Revenues	$ 2,701.9	$ 958.0	$ –	$ (4.8)	$ 3,655.1
Operating expenses	2,149.6	844.0	–	(183.7)	2,809.9
Operating income	552.3	114.0	–	178.9	845.2
Interest and other charges	225.9	18.4	(56.3)	–	188.0
Foreign exchange loss on long-term debt	32.1	–	–	–	32.1
Income taxes	76.1	17.8	4.4	24.2	122.5
Net income	$ 218.2	$ 77.8	$ 51.9	$ 154.7	$ 502.6
Current assets	$ 543.8	$ 276.0	$ 71.6	$ (62.0)	$ 829.4
Net properties	4,773.4	1,768.9	–	847.0	7,389.3
Other long-term assets	400.4	39.2	–	(0.1)	439.5
Total assets	$ 5,717.6	$ 2,084.1	$ 71.6	$ 784.9	$ 8,658.2
Current liabilities	$ 897.1	$ 317.3	$ 12.8	$ (64.3)	$ 1,162.9
Long-term liabilities	3,306.3	587.1	44.0	122.3	4,059.7
Shareholder's equity	1,514.2	1,179.7	14.8	726.9	3,435.6
Total liabilities and shareholder's equity	$ 5,717.6	$ 2,084.1	$ 71.6	$ 784.9	$ 8,658.2

The condensed income statement and balance sheet for the Canadian operations have been prepared in accordance with the Uniform Classification of Accounts issued by the Canadian Transportation Agency in Canada. The changes required to consolidate the Canadian operations are identified above as consolidating entries with the exception of amounts adjusting current assets and liabilities, which are eliminations of inter-company balances between countries.

23. RECLASSIFICATION

Certain prior years' figures have been reclassified to conform with the presentation adopted for 2002.

24. SUPPLEMENTARY DATA

Reconciliation of Canadian and United States Generally Accepted Accounting Principles
The consolidated financial statements of the Company have been prepared in accordance with GAAP in Canada. The material differences between Canadian and U.S. GAAP relating to measurement and recognition are explained below, along with their effect on the Company's statement of consolidated income and balance sheet. Certain additional disclosures as required under U.S. GAAP have not been provided, as permitted by the Securities Exchange Commission.

Accounting for Derivative Instruments and Hedging
Effective January 1, 2001, Financial Accounting Standards Board ("FASB") Statement No. 133 "Accounting for Derivative Instruments and Hedging Activities" ("FASB 133"), and FASB Statement No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities" ("FASB 138") became effective for U.S. GAAP. FASB 133 and FASB 138 permit hedging of cash flows when specific documentation is in place from inception of the hedge and the hedge meets effectiveness testing on an ongoing basis. All derivative instruments are recognized on the balance sheet at fair value with changes in fair value being recorded in comprehensive income until the hedged transaction occurs, at which time these amounts are included in the income statement. Under Canadian GAAP, derivative instruments are not recorded on the balance sheet at fair value and gains or losses are included in the income statement when the hedged transaction occurs.

Prior to January 1, 2001, under FASB Statement No. 52 "Foreign Currency Translation" ("FASB 52") for U.S. reporting purposes, forward foreign exchange contracts associated with anticipated future transactions that do not constitute firm commitments are recognized in the financial statements at fair value, with any resulting gains or losses immediately reflected in income. Under Canadian GAAP, certain of these forward foreign exchange contracts qualify as hedges for accounting purposes. Consequently, the fair value of these unsettled contracts is not reflected in the financial statements and any realized gains or losses are only recognized at the time of completion of the hedged transactions.

Pensions and Post-retirement Benefits
Effective January 1, 2000, the Company adopted prospectively CICA Section 3461 "Employee Future Benefits." Canadian GAAP policy requires amortization of actuarial gains and losses only if they exceed 10 % of the greater of the benefit obligation and the market-related value of the plan assets ("the corridor"). This harmonizes the Canadian GAAP treatment with FASB Statement No. 87 "Employers' Accounting for Pensions" ("FASB 87") and FASB Statement No. 106 "Employers' Accounting for Post-retirement Benefits Other Than Pensions" ("FASB 106"). Previously, all actuarial gains and losses were amortized under Canadian GAAP.

Upon transition to CICA Section 3461 effective January 1, 2000, all unamortized gains and losses, including prior service costs, were accumulated into a net transitional asset which is being amortized to income. This created a difference compared with U.S. GAAP in 2002, 2001 and 2000, under which prior service costs continued to be amortized over the expected average remaining service period and all other net gains accumulated prior to January 1, 2000, fell within the corridor.

Post-employment Benefits

Post-employment benefits are covered by the CICA recommendations for accounting for employee future benefits. Consistent with accounting for post-retirement benefits, the new policy requires amortization of actuarial gains and losses only if they fall outside of the corridor. Under FASB Statement No. 112 "Employers' Accounting for Post-employment Benefits," such gains and losses are included immediately in income.

Termination Benefits

Termination benefits are also covered by CICA Section 3461. Upon transition to this accounting policy effective January 1, 2000, a net transitional asset was created and is being amortized to income. Under U.S. GAAP, benefits are expensed when paid.

Stock-based Compensation

Under FASB Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation," a compensation expense must be recorded if the intrinsic value of stock options is not exactly the same immediately before and after an equity restructuring. As a result of the CPL corporate reorganization (see Note 1), CPL underwent an equity restructuring, which resulted in replacement options in new CPRL stock having a different intrinsic value after the restructuring than prior to it. Canadian GAAP does not require revaluation of these options.

Internal Use Software

Under the American Institute of Certified Public Accountants Statement of Position No. 98-1 "Accounting for the costs of computer software developed or obtained for internal use," certain costs, including preliminary project phase costs, are required to be expensed as incurred. These costs are capitalized under Canadian GAAP.

Capitalization of Interest

The Company expenses interest related to capital projects undertaken during the year. FASB Statement No. 34 "Capitalization of Interest Cost" requires these interest costs to be capitalized.

Income Taxes

Effective January 1, 2000, the Company adopted retroactively without restatement CICA Section 3465 "Future Income Taxes." This policy, which requires the use of the liability method, is effectively identical to FASB Statement No. 109 "Accounting for Income Taxes" ("FASB 109"), thus eliminating prior-year differences. On adoption of CICA Section 3465 in 2000, the cumulative adjustment was taken to retained earnings for Canadian GAAP. Canadian GAAP requires the use of substantively enacted tax rates for the calculation of future income taxes, whereas under FASB 109, only enacted tax rates can be used. In the period 2000 to 2002, reduced income tax rates were substantively enacted in Canada, for which, under U.S. GAAP, the benefit could not be recognized until the rate changes were enacted.

Comprehensive Income

FASB Statement No. 130 "Reporting Comprehensive Income" requires disclosure of the change in equity from transactions and other events from non-owner sources during the period. Canadian GAAP does not require similar disclosure. In 2002, other comprehensive income arose from foreign currency translation on the net investment in self-sustaining foreign subsidiaries as well as other foreign currency translation adjustments, foreign currency translation related to long-term debt designated as a hedge of the net investment in self-sustaining foreign subsidiaries, minimum pension liability and derivative instrument adjustments. In 2001 and 2000, other comprehensive income arose from foreign currency translation, minimum pension liability and derivative instrument adjustments.

Assets Purchased Through Conditional Sales Agreement

The Company acquired assets through lease agreements which included conditional sales agreements and a put option to sell the assets to a third party in the future. Under Canadian GAAP, this transaction meets the accounting guidelines for an operating lease and has been accounted for as such. Under U.S. GAAP, FASB Statement No. 13 "Accounting for Leases" states that conditional sales agreements must be accounted for as capital leases.

Impairment or Disposal of Long-lived Assets

On January 1, 2002, the Company adopted FASB Statement No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FASB 144"). FASB 144 supersedes FASB Statement No. 121 "Accounting for the Impairment of Long-Lived Assets to be Disposed of." FASB 144 applies to all long-lived assets and, consequently, amends Accounting Principles Board Opinion No. 30 "Reporting Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The impact of adopting FASB 144 was immaterial.

Debt Extinguishment

In the second quarter of 2002, CPR early adopted prospectively FASB Statement No. 145 "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("FASB 145"). During 2002, CPR redeemed long-term debt that was due 2022 and incurred a penalty for early redemption. Under U.S. GAAP, this transaction is now treated the same as under Canadian GAAP. There were no such transactions in 2001 and 2000 that would require restatement under FASB 145.

Additional Minimum Pension Liability

In accordance with FASB 87, the Company recorded an additional minimum pension liability for underfunded plans representing the excess of unfunded accumulated benefit obligation over previously recorded pension cost liabilities. The increase in liabilities is charged directly to shareholders' equity, net of related deferred income taxes. Under Canadian GAAP, there is no requirement to set up a minimum pension liability based on an annual funding test.

Future Accounting Changes

In June 2001, the FASB issued Statement No. 143 "Accounting for Asset Retirement Obligations" ("FASB 143"), which requires that an asset retirement obligation be recognized as a liability, measured at fair value, in the period in which the obligation is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and amortized to expense over the asset's useful life. FASB 143 is effective for fiscal years beginning after June 15, 2002. The effect on net income of adopting this standard on January 1, 2003, has not yet been determined.

In June 2002, the FASB issued Statement No. 146 "Accounting for Costs Associated with Exit or Disposal Activities" ("FASB 146"). FASB 146: addresses accounting and reporting of costs associated with exit or disposal activities, nullifying Emerging Issues Task Force Abstract No. 94-3; requires recognition and measurement of a liability, at fair value, for a cost associated with an exit or disposal activity only when the liability is incurred; and, specifies that a liability for such a cost is incurred when the definition of a liability in FASB Statement No. 6 is met. FASB 146 is effective for exit or disposal activities initiated after December 31, 2002. The Company adopted this standard prospectively on January 1, 2003. The impact of adopting this standard is not anticipated to be material.

In January 2003, the FASB issued Financial Interpretation No. 46 "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51" ("FIN 46"). FIN 46 requires that when the majority equity owner of a variable interest entity holds an equity ownership representing less than 10 % of the total assets of the variable interest entity, the primary beneficiary of the variable interest entity is required to consolidate the variable interest entity. FIN 46 is effective for fiscal periods beginning after June 15, 2003, for variable interests acquired before February 1, 2003, and immediately for variable interests created after January 31, 2003. Effective January 1, 2003, the Company early adopted FIN 46 prospectively. The Company has one variable interest entity of which it is the primary beneficiary and meets the criteria for consolidation. The impact of consolidating the variable interest entity will be to increase net properties by approximately $208.0 million and long-term debt by approximately $209.0 million.

In December 2002, the FASB issued Financial Interpretation No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statements No. 5, 57 and 107" ("FIN 45"). FIN 45 requires that, effective for years beginning after September 15, 2002, a guarantor recognizes, at the inception of a guarantee, a liability for the fair value of the obligations it has undertaken in issuing the guarantee. The impact of adopting FIN 45 on January 1, 2003, is not anticipated to be material.

Statement of Cash Flows

There are no material differences in the statement of consolidated cash flows under U.S. GAAP.

Comparative Income Statement

Net income is reconciled from Canadian to U.S. GAAP in the following manner:

(in millions)	2002	2001	2000
Net income – Canadian GAAP	$ 496.0	$ 372.5	$ 502.6
Increased (decreased) by:			
Pension costs	(44.8)	(37.6)	(37.0)
Post-retirement benefits	8.3	7.9	8.5
Post-employment benefits	(0.5)	5.8	(17.9)
Termination benefits	(14.7)	(11.7)	5.4
Internal use software	(6.4)	(12.0)	(20.5)
Conditional sales agreements	(1.1)	–	–
Stock-based compensation	(6.2)	(9.0)	–
Derivative instruments (FASB 52)	–	–	(14.3)
Capitalized interest	2.2	3.6	2.9
Future (deferred) income tax recovery on the above items	22.8	18.9	34.3
Substantively enacted tax rate adjustment	–	131.7	(131.7)
Future (deferred) income taxes – effect of change in accounting policy	–	–	(65.3)
Income before cumulative catch-up adjustment – U.S. GAAP	455.6	470.1	267.0
Cumulative catch-up adjustment on adoption of FASB 133, net of tax	–	9.6	–
Net income – U.S. GAAP	$ 455.6	$ 479.7	$ 267.0
Other comprehensive income:			
Unrealized foreign exchange (loss) gain on net investment in self-sustaining U.S. subsidiaries	(8.3)	44.1	17.1
Unrealized foreign exchange gain on designated hedge	8.3	–	–
Other changes in the foreign currency translation adjustment	(3.2)	(2.9)	(0.6)
Minimum pension liability adjustment	(394.0)	(10.7)	(7.1)
Derivative instruments (FASB 133)	25.9	(25.0)	–
Future (deferred) income tax (expense) recovery on the above items	149.0	(1.8)	(5.7)
Comprehensive income	$ 233.3	$ 483.4	$ 270.7
Earnings per share – U.S. GAAP			
Basic earnings per share before cumulative catch-up adjustment	$ 2.87	$ 2.97	$ 1.69
Diluted earnings per share before cumulative catch-up adjustment	$ 2.86	$ 2.96	$ 1.68

A summary of railway operating income resulting from Canadian and U.S. GAAP differences is as follows:

(in millions)	**2002**	2001	2000
Operating income			
Canadian GAAP	**$ 856.5**	$ 816.5	$ 845.2
U.S. GAAP	**$ 795.8**	$ 759.9	$ 783.7

Balance Sheet

Had the consolidated balance sheet been prepared under U.S. GAAP, the differences would have been as follows (higher/(lower)):

(in millions)	**2002**	2001
Assets		
Long-term assets		
Properties		
Capitalized interest	**$ 147.6**	$ 145.5
Internal use software	**(38.9)**	(32.5)
Assets purchased through conditional sales agreements	**207.8**	216.7
Other assets and deferred charges		
Pension	**(169.0)**	(124.2)
Minimum pension liability adjustment	**(2.7)**	6.9
Total assets	**$ 144.8**	$ 212.4
Liabilities and shareholders' equity		
Long-term liabilities		
Deferred liabilities		
Termination benefits	**$ (56.0)**	$ (70.7)
Post-retirement benefit liability	**69.7**	78.0
Post-employment benefit liability	**12.6**	12.1
Minimum pension liability adjustment	**409.1**	24.7
Derivative instruments	**(0.9)**	25.0
Long-term debt		
Assets purchased through conditional sales agreements	**208.9**	216.7
Future income tax liability	**(148.1)**	23.8
Total liabilities	**495.3**	309.6
Shareholders' equity		
Share capital		
Stock-based compensation	**4.3**	1.6
Contributed surplus		
Stock-based compensation	**10.9**	7.4
Foreign currency translation adjustments	**(122.3)**	(125.5)
Retained income	**(65.8)**	(25.4)
Accumulated other comprehensive income		
Foreign currency translation adjustments	**67.6**	69.5
Minimum pension liability adjustment	**(246.7)**	(10.8)
Derivative instruments (FASB 133)	**1.5**	(14.0)
Total liabilities and shareholders' equity	**$ 144.8**	$ 212.4

FIVE-YEAR SUMMARY

(in millions)	2002	2001 (1)	2000 (1)	1999 (1)	1998 (1)
Income statement					
Revenues					
Freight					
Grain	**$ 631.4**	$ 749.3	$ 755.2	$ 687.5	$ 740.6
Coal	**442.5**	474.1	387.8	391.6	449.0
Sulphur and fertilizers	**401.3**	380.7	425.8	419.6	452.9
Forest products	**360.3**	354.4	365.9	361.2	324.7
Industrial products	**422.1**	430.7	438.1	433.0	430.4
Intermodal	**881.9**	803.6	781.9	751.8	679.3
Automotive	**332.4**	303.9	305.4	278.9	238.3
	3,471.9	3,496.7	3,460.1	3,323.6	3,315.2
Other (2) (4)	**193.7**	201.9	195.0	172.8	156.9
Total revenues (2) (4)	**3,665.6**	3,698.6	3,655.1	3,496.4	3,472.1
Operating expenses					
Compensation and benefits	**1,131.1**	1,122.1	1,147.8	1,173.2	1,150.8
Fuel	**357.5**	403.0	409.7	279.2	281.6
Materials	**165.7**	180.9	213.3	199.4	234.6
Equipment rents	**255.0**	272.1	266.7	269.7	258.3
Depreciation	**348.4**	334.4	304.7	292.5	279.0
Purchased services and other	**551.4**	545.1	467.7	520.1	547.1
Total operating expenses, excluding spin-off related and incentive compensation charges (2) (4)	**2,809.1**	2,857.6	2,809.9	2,734.1	2,751.4
Operating income, excluding spin-off related and incentive compensation charges (2) (4)	**856.5**	841.0	845.2	762.3	720.7
Other charges, excluding foreign exchange gains and losses on long-term debt and bridge financing fees related to spin-off (2) (3) (4)	**21.8**	26.4	21.0	21.8	13.6
Interest expense	**242.2**	209.6	167.0	136.6	118.5
Income tax expense, excluding foreign exchange gains and losses on long-term debt and income tax on non-recurring items (2) (3) (4)	**185.2**	224.7	247.1	235.4	257.4
Income, excluding non-recurring items and foreign exchange gains and losses on long-term debt (2) (3) (4)	**$ 407.3**	$ 380.3	$ 410.1	$ 368.5	$ 331.2
Foreign exchange gain (loss) on long-term debt (net of income tax) (3)	**16.7**	(48.2)	(39.2)	37.5	(33.3)
Non-recurring items (net of income tax) (2)	**72.0**	40.4	131.7	(301.5)	28.4
Net income	**$ 496.0**	$ 372.5	$ 502.6	$ 104.5	$ 326.3

(1) Restated. Effective January 1, 2002, CPR adopted retroactively with restatement the new Canadian Institute of Chartered Accountants accounting standard for the treatment of foreign exchange gains and losses on long-term debt.

(2) Excluding non-recurring items as follows: For 2002, $72 million in income tax recoveries associated with a favourable court ruling related to prior years' taxes; for 2001, $24.5 million ($13.9 million after tax) in spin-off related and incentive compensation charges, $17.2 million ($9.7 million after tax) in bridge financing fees, and $64.0 million in income tax rate recoveries; for 2000, $131.7 million in income tax recoveries associated with a decrease in Canadian federal income tax rates; for 1999, $500.6 million ($301.5 million after tax) in charges comprised of $472.2 million in restructuring charges and a one-time charge of $28.4 million mostly related to Year 2000 remediation work; for 1998, a $44.4-million ($44.4 million after tax) gain on the sale of Coastal Marine Operations offset by $29.1 million ($16.0 million after tax) in charges related to Year 2000 remediation work.

(3) Excluding foreign exchange gain (loss) on long-term debt as follows: For 2002, a $13.4-million ($16.7 million after tax) foreign exchange gain on long-term debt; for 2001, a $58.2-million ($48.2 million after tax) foreign exchange loss on long-term debt; for 2000, a $32.1-million ($39.2 million after tax) foreign exchange loss on long-term debt; for 1999, a $39.6-million ($37.5 million after tax) foreign exchange gain on long-term debt; for 1998, a $48.1-million ($33.3 million after tax) foreign exchange loss on long-term debt.

(4) These are earnings measures that are not in accordance with GAAP and may not be comparable to similar measures of other companies. CPR's results, excluding foreign exchange gains and losses on long-term debt and non-recurring items as defined in this summary, are presented to provide the reader with information that is readily comparable to prior years' results. By excluding foreign exchange gains and losses on long-term debt, the impact of volatile short-term exchange rate fluctuations, which can only be realized when long-term debt matures or is settled, is largely eliminated. By also excluding non-recurring items, the results better reflect ongoing operations at CPR.

Shareholder Information

COMMON SHARE MARKET PRICES

	2002		2001	
Toronto Stock Exchange (Canadian dollars)	**high**	**low**	high	low
First quarter	**34.64**	**29.80**	–	–
Second quarter	**37.75**	**31.70**	–	–
Third quarter	**37.98**	**28.26**	–	–
Fourth quarter	**33.75**	**26.93**	32.95	22.50
Year	**37.98**	**26.93**	32.95	22.50
New York Stock Exchange (U.S. dollars)	**high**	**low**	high	low
First quarter	**22.42**	**18.67**	–	–
Second quarter	**24.60**	**19.99**	–	–
Third quarter	**24.99**	**17.85**	–	–
Fourth quarter	**21.50**	**17.06**	20.50	14.50
Year	**24.99**	**17.06**	20.50	14.50
Number of registered shareholders at year end				23,703
Market prices at year end				
Toronto Stock Exchange				CDN$31.15
New York Stock Exchange				US$19.70

Shareholder Administration

Common Shares

Computershare Trust Company of Canada, with transfer facilities in Montreal, Toronto, Calgary and Vancouver, serves as transfer agent and registrar for the Common Shares in Canada. Computershare Trust Company of New York serves as co-transfer agent and co-registrar for the Common Shares in New York.

For information concerning dividends, lost share certificates and estate transfers or for change in share registration or address, please contact the transfer agent and registrar by telephone at 1-800-332-0095 or (514) 982-7800, by fax at 1-888-453-0330, or by e-mail at caregistryinfo@computershare.com, or write to:

Computershare Trust Company of Canada
9th Floor, 100 University Avenue, Toronto, Ontario Canada M5J 2Y1

4 % Consolidated Debenture Stock

Inquiries with respect to the Canadian Pacific Railway 4 % Consolidated Debenture Stock should be directed to the transfer agent and registrar as follows:

for stock denominated in U.S. currency – The Bank of New York at (212) 815-5346, or by e-mail at vmack@bankofny.com; and

for stock denominated in pounds sterling – BNY Trust Company of Canada at (416) 933-8504, or by e-mail at mredway@bankofny.com.

Market for Securities

The Common Shares of Canadian Pacific Railway Limited are listed on the Toronto and New York stock exchanges. The Debenture Stock is listed on the London, England Stock Exchange (sterling) and on the New York Stock Exchange (U.S. currency).

Trading Symbol

Common Shares – CP

Duplicate Annual Reports

While every effort is made to avoid duplication, some Canadian Pacific Railway Limited registered shareholders may receive multiple copies of shareholder information mailings such as this Annual Report. Registered shareholders who wish to consolidate any duplicate accounts that are registered in the same name are requested to write to Computershare Trust Company of Canada.

Direct Deposit of Dividends

Registered shareholders are offered the option of having their Canadian dollar dividends directly deposited into their personal bank accounts in Canada on the dividend payment dates. Shareholders who receive their dividends in Canadian currency may obtain a direct deposit enrolment form from Computershare Trust Company of Canada.

Corporate Governance

Canadian Pacific Railway's Board of Directors and its management are committed to a high standard of corporate governance. We believe that effective corporate governance calls for the establishment of processes and structures that contribute to the sound direction and management of the Corporation's business, with a view to enhancing shareholder value.

Under the rules of the Toronto Stock Exchange ("TSX"), CPR is required to disclose information relating to its system for corporate governance. CPR's disclosure addressing each of the TSX's guidelines is set out in Appendix 1 to the Management Proxy Circular issued in connection with the 2003 Annual Meeting of Shareholders.

Directors

Stephen E. Bachand (1) (2) (4)
Former President and Chief Executive Officer
Canadian Tire Corporation, Limited
Ponte Vedra Beach, Florida

John E. Cleghorn, O.C., F.C.A. (1) (2) (5)
Chairman
SNC-Lavalin Group Inc.
Toronto, Ontario

Jacques Lamarre (2) (3) (5)
President and Chief Executive Officer
SNC-Lavalin Group Inc.
Montreal, Quebec

James E. Newall, O.C. (1) (2) (3) (4) (5)
Chairman
Canadian Pacific Railway Limited, and
NOVA Chemicals Corporation
Calgary, Alberta

Dr. James R. Nininger (2) (3) (4)
Retired President and Chief Executive Officer
The Conference Board of Canada
Ottawa, Ontario

Madeleine Paquin (2) (3)
President and Chief Executive Officer
Logistec Corporation
Montreal, Quebec

Michael E.J. Phelps, O.C. (2) (3) (4)
Chairman
Dornoch Capital Inc.
West Vancouver, British Columbia

Roger Phillips, O.C. (1) (2) (5)
Retired President and Chief Executive Officer
IPSCO Inc.
Regina, Saskatchewan

Robert J. Ritchie
President and Chief Executive Officer
Canadian Pacific Railway Limited
Calgary, Alberta

The Rt. Hon., The Viscount Weir (2) (3) (5)
Chairman
Balfour Beatty plc
Ayrshire, Scotland

Michael W. Wright (1) (2) (4)
Retired Chairman of the Board
SUPERVALU INC.
Longboat Key, Florida

Senior Officers of the Company

James E. Newall, O.C.
Chairman of the Board
Calgary, Alberta

Robert J. Ritchie (6)
President and Chief Executive Officer
Calgary, Alberta

Edwin V. Dodge (6)
Executive Vice-President and Chief Operating Officer
Calgary, Alberta

Michael T. Waites (6)
Executive Vice-President and Chief Financial Officer
Calgary, Alberta

Allen H. Borak (6)
Vice-President, Information Services
Calgary, Alberta

Paul Clark (6)
Vice-President, Communications and Public Affairs
Calgary, Alberta

R. Andrew Shields (6)
Vice-President, Human Resources and Industrial Relations
Calgary, Alberta

Marcella M. Szel, Q.C. (6)
Vice-President, Strategy and Law, Corporate Secretary
Calgary, Alberta

W. Paul Bell
Vice-President, Investor Relations
Calgary, Alberta

William D. Gantous
Vice-President and Treasurer
Calgary, Alberta

Brian Grassby
Vice-President and Comptroller
Calgary, Alberta

(1) Audit, Finance and Risk Management Committee
(2) Corporate Governance and Nominating Committee
(3) Environmental and Safety Committee
(4) Management Resources and Compensation Committee
(5) Pension Trust Fund Committee
(6) Management Executive Committee of Canadian Pacific Railway

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OUR VISION CPR's vision is to be the preferred business partner in rail-based transportation services. To provide our customers the best service possible, we organize our rail freight business into three groups – Bulk, Carload and Intermodal & Automotive – because each group has its own distinct service and equipment requirements.

BULK

The Bulk Group serves CPR's grain, fertilizer, coal and sulphur customers. CPR meets their unique needs by providing single-commodity train service to North American markets and to major ports for export.

CPR carries grain and other agricultural products from the Canadian prairies and North Dakota and Minnesota. We transport fertilizers from Alberta and Saskatchewan for overseas and domestic markets. CPR offers the shortest route from most of the key grain and fertilizer producing areas in western Canada to the Port of Vancouver.

We ship high-grade metallurgical coal produced in Canada for overseas export, and transport coal produced in Illinois, Indiana and Wyoming for generating power.

CPR is also the leading carrier of formed sulphur for export markets and is the largest carrier of liquid sulphur from Alberta to the southeastern U.S.

INTERMODAL & AUTOMOTIVE

CPR's intermodal freight consists primarily of manufactured consumer products.

Domestic intermodal is mostly long-haul, east-west traffic moving in containers and trailers. International intermodal traffic moves in containers between the ports of Vancouver, Montreal, New York, and Philadelphia and inland points across Canada and in the U.S.

CPR is the leading rail service provider to the container shipping lines calling at the Port of Montreal. Our Montreal-Chicago corridor is the shortest route for European goods destined for the U.S. Midwest. CPR handles the majority of containers moving through the Port of Vancouver, Canada's largest port. Short route and fast delivery make CPR a strong competitor for trans-Pacific containers moving between Vancouver and Chicago.

CPR transports finished vehicles and parts for automotive customers. We move import vehicles from the Port of Vancouver to Chicago and eastern Canada. CPR has direct access to 10 major vehicle assembly plants in Ontario and Minnesota. Through interline connections, CPR also moves vehicles assembled in Mexico.

CARLOAD

Forest and industrial products comprise CPR's growing Carload business, so-called because these goods typically do not move in entire trainloads.

We transport forest products – lumber, newsprint, pulp, paper, paperboard, panel and Oriented Strand Board – from all the major Canadian production areas.

CPR also carries a wide range of industrial products including chemicals, energy-related commodities, aggregates and steel. Our eight cross-border gateways provide Canadian shippers with direct access to U.S. markets.

Canadian Pacific Railway

INVESTOR RELATIONS

Financial information, including Canadian Pacific Railway's Corporate Profile and Fact Book, is available on CPR's website at www.cpr.ca or by contacting: **Paul Bell**, Vice-President, Investor Relations, Canadian Pacific Railway, Ste 500, Gulf Canada Square, 401 - 9th Avenue S.W., Calgary, Alberta Canada T2P 4Z4; e-mail at investor@cpr.ca

COMMUNICATIONS & PUBLIC AFFAIRS

Paul Clark, Vice-President, Communications and Public Affairs, Canadian Pacific Railway, Ste 500, Gulf Canada Square, 401 - 9th Avenue S.W., Calgary, Alberta Canada T2P 4Z4

SHAREHOLDER SERVICES

Shareholders who have inquiries or wish to obtain copies of the Corporation's Annual Information Form may contact Shareholder Services at 1-866-861-4289 or (403) 319-7538, or by e-mail at shareholder@cpr.ca, or by writing to: Shareholder Services, Office of the Corporate Secretary, Canadian Pacific Railway, Ste 2000, Gulf Canada Square, 401 - 9th Avenue S.W., Calgary, Alberta Canada T2P 4Z4

2003 ANNUAL MEETING OF SHAREHOLDERS

The Annual Meeting of Shareholders will be held on Monday, April 28, 2003, at the Vancouver Convention & Exhibition Centre, 999 Canada Place, Vancouver, British Columbia, at 9 a.m., Pacific time.

Si vous désirez vous procurer la version française du présent rapport, veuillez vous adresser au : Vice-président exécutif et chef des services financiers, **Canadian Pacific Railway**, Suite 500, Gulf Canada Square, 401 – 9th Avenue S.W., Calgary, Alberta Canada T2P 4Z4
www.cpr.ca

Responsible Care: A Total Commitment